FORM 10-K

Annual report pursuant to section 13 and 15(d)

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PEERLESS SYSTEMS CORP

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended January 31, 2005

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number: 000-21287

Peerless Systems Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware *(State or Other Jurisdiction of Incorporation or Organization)*	**95-3732595** *(I.R.S. Employer Identification No.)*
2381 Rosecrans Avenue, El Segundo, CA *(Address of Principal Executive Offices)*	**90245** *(Zip Code)*

Registrant' s telephone number, including area code
(310) 536-0908

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

Common Stock, $.001 Par Value Per Share
(Title of Class)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☐ No ☑

The approximate aggregate market value of the Common Stock held by non-affiliates of the Registrant, based upon the last sale price of the Common Stock reported on the Nasdaq SmallCap Market on July 31, 2004 was approximately $15,994,533.

The number of shares of Common Stock outstanding as of April 26, 2005 was 16,387,584.

DOCUMENTS INCORPORATED BY REFERENCE

Certain parts of the Peerless Systems Corporation Proxy Statement relating to the annual meeting of stockholders to be held on or around June 30, 2005 (the "Proxy Statement") are incorporated by reference into Part III of this Annual Report on Form 10-K.

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SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Statements prompted by, qualified by or made in connection with such words as "may," "will be," "continue," "anticipates," "estimates," "expects," "continuing," "plans," "exploring," "intends," and "believes" and words of similar substance signal forward-looking statements. Likewise, the use of such words in connection with or related to any discussion of or reference to the Company' s future business operations, opportunities or financial performance sets apart forward-looking statements.

In particular, statements regarding the Company' s outlook for future business, financial performance and growth, including projected revenue, both quarterly and from specific sources, profit, spending, including spending on research and development efforts, costs, margins, the timing and number of design wins, and the Company' s cash position, as well as statements regarding expectations for the digital imaging market, new product development and offerings, customer demand for the Company' s products and services, market demand for products incorporating the Company' s technology, future prospects of the Company, and the impact on future performance of organizational and operational changes; all constitute forward-looking statements.

These forward-looking statements are just projections and estimations based upon the information available to the Company at this time. Thus they involve known and unknown factors and trends affecting Peerless and its business such that actual results could differ materially from those projected in the forward-looking statements made in this Annual Report on Form 10-K. Risks and uncertainties include, but are not limited to: (a) if Kyocera Mita Corporation and the Company do not enter into definitive agreements in support or replacement of the Memorandum of Understanding (MOU) between the companies, it may harm the Company' s financial results; (b) under new regulations required by the Sarbanes-Oxley Act of 2002, an adverse opinion on internal controls over financial reporting could be issued by our independent registered public accounting firm, and this could have a negative impact on our stock price; (c) recent and proposed regulations related to equity incentives could adversely affect our ability to attract and retain key personnel; (d) the impact of Microsoft' s "Longhorn" operating system could have an adverse impact on the Company' s future licensing revenues; (e) the Company' s near term revenue may drop as a result of the timing of licensing revenues and the reduced demand for its existing monochrome technologies; (f) if the Company is unable to achieve its expected level of sales of *Peerless Sierra Technologies*, the Company' s future revenue and operating results may be harmed; (g) if the marketplace does not accept Peerless' new *Peerless Sierra Technologies*, the Company' s future revenue and operating results may be harmed; (h) the Company' s forecasts for its Everest controller may not be realized, and losses for the disposition of excess inventories may result; (i) the Company' s existing capital resources may not be sufficient and if Peerless is unable to raise additional capital, the Company' s business may suffer; (j) Peerless has a history of losses; (k) the future demand for the Company' s current products is uncertain; (l) Peerless relies on relationships with certain customers and any adverse change in those relationships will harm the Company' s business; (m) Peerless relies on relationships with Adobe Systems Incorporated and Novell Inc., and any adverse change in those relationships will harm the Company' s business; (n) the Company, as a sublicensor of third party intellectual property, is subject to audits of the Company' s licensing fee costs; and (o) the Company has negotiated with Adobe Systems Incorporated and Canon Inc. to remedy a contract dispute, which, if not remedied, could result in the loss of the Adobe agreement and harm to the Company' s business. Those factors and trends affecting Peerless and its business include those set forth in pages 16 through 25 of this Annual Report on Form 10-K.

Current and prospective stockholders are urged not to place undue reliance on forward-looking statements, as such statements speak only as of the date hereof. The Company is under no obligation, and expressly disclaims any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. All forward-looking statements contained herein are qualified in their entirety by the foregoing cautionary statements.

PEERLESS SYSTEMS CORPORATION

ANNUAL REPORT ON FORM 10-K
For the Year Ended January 31, 2005

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TRADEMARKS

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PART I

Item 1. Business

Peerless Systems Corporation, together with its wholly-owned subsidiary Peerless Systems Imaging Products, Inc. (together, "Peerless" or the "Company"), licenses software-based imaging and networking technology for controllers in embedded, attached and stand-alone digital document products and integrates proprietary software into the printers, copiers, and multifunction products of original equipment manufacturers ("OEMs").

The Company has developed and continues to develop controller products and applications for sale to OEMs and distribution channels. Digital document products include monochrome (black and white) and color printers, copiers, fax machines and scanners, as well as multifunction products ("MFPs") that perform a combination of these imaging functions. In order to process digital text and graphics, digital document products rely on a core set of imaging software and supporting electronics, collectively known as a digital imaging system. Network interfaces supply the core technologies to digital document products that enable them to communicate over local and wide area networks and the Internet. The Peerless family of products and engineering services provide fully integrated advanced and proprietary imaging and networking technologies that enable the Company' s OEM customers and third party developers for OEMs to develop stand-alone and networked digital printers, copiers, and MFPs quickly and cost effectively. The Company markets its solutions directly to OEM customers including Canon, KonicaMinolta, Kyocera Mita, Lenovo (formerly Legend), Oki Data, Panasonic, Ricoh, and Seiko Epson. The Company has expanded its solution offerings by incorporating related imaging and networking technologies developed internally or licensed from third parties. The Company has developed more diverse distribution channels for its products and expanded its target markets to distributors, value added resellers, system integrators, OEM sales operations, and geographically to the People' s Republic of China.

The Company' s traditional embedded development focus has historically been to offer high performing systems at a lower cost compared to competitive offerings. Peerless controllers achieve their performance objectives by interpreting printer description languages such as Adobe PostScript3, PeerlessPrint®5C or PeerlessPrint®5E, PeerlessPrint®6, and PeerlessPrint®7 while simultaneously executing raster image processing commands on Peerless' proprietary co-processor. Lower component costs result from reducing the amount of random access memory ("RAM") required to process raster images through the use of Peerless' proprietary application specific integrated circuit ("ASIC") compression technology. Integrating network components further reduces the cost of Peerless' solutions and software typically supplied by third party technology vendors in separately mounted network interface cards. Peerless software has a modular architecture allowing for fast replacement of the key components required to support new printer and copier engine interfaces. This architecture helps OEMs meet the fast time to market requirements in today' s hardcopy imaging business. These three core areas of higher performance, lower cost, and fast time to market describe the competitive advantages of Peerless technologies in the printer controller markets.

In addition to its core monochrome technologies, Peerless has recently developed and commercialized a high performance color imaging and printing technology and new open architecture named *"Peerless Sierra Technologies."* Peerless believes that based on the *Peerless Sierra Technologies* architecture, it can address key growth areas in the imaging market including: increased demand for color imaging, the emergence of MFPs, and continued demand for faster low cost monochrome printing solutions. The *Peerless Sierra Technologies* line of products can produce high resolution color quality imaging on an architecture that can print full continuous tone ("contone") color at speeds ranging from 20 pages per minute up to 100 pages per minute (or more). *Peerless Sierra Technologies* can achieve monochrome printing speeds well in excess of 150 pages per minute. The Company' s commercial launch of its Everest controllers based on this technology took place in the fourth quarter of fiscal year 2005. Shipments of the controllers are being made to select product dealers. Peerless believes that its new *Peerless Sierra Technologies* will contribute an increasing percentage of the Company' s overall revenue in the future.

In June 1999, Peerless acquired Auco, Inc., which became a wholly-owned subsidiary of the Company and was re-named Netreon, Inc. ("Netreon"). While retaining the networking technology related to imaging obtained from the acquisition, on January 29, 2002, Peerless divested itself of Netreon and the network storage components. The Company continued to hold a minority interest in the newly independent storage management software company arising from the divestiture through the fiscal year ended January 31, 2003. All interest in Netreon was sold for $1 million on February 2, 2003, just after the close of fiscal year 2003.

In December 1999, the Company acquired HDE, Inc. ("HDE"), a developer of digital imaging and Internet printing products. After the acquisition, HDE' s name was changed to Peerless Systems Imaging Products, Inc. ("PSIP") and PSIP became a wholly-owned subsidiary of Peerless. This acquisition expanded Peerless' presence in the digital imaging and Internet printing solutions markets, and added new customers to the Company' s portfolio. In conjunction with PSIP' s strategic relationship with Adobe Systems Incorporated, Peerless now ranks among the leading embedded Adobe PostScript suppliers to the imaging market. PSIP has engaged in the development of Internet printing solutions, such as enabling users to print without the need to load printer drivers on their computing device. PSIP also supports the development of imaging technologies as applied to advanced architectures, fax, imaging enhancement, and workflow control.

Peerless was incorporated in California in 1982 and reincorporated in Delaware in September 1996. Peerless makes its periodic and current reports and amendments to such reports available, free of charge, on its website *(www.peerless.com)* as soon as reasonably practicable after such filing is electronically filed with, or furnished to the Securities and Exchange Commission.

Digital Document Products − Industry Background

The Company believes today' s office and home/office environment is increasingly dependent on a variety of electronic imaging products such as printers, copiers, fax machines, scanners, and MFP devices. Historically, most electronic imaging products in the office environment have been stand-alone, monochrome machines, which were dedicated to a single print, copy, fax or scan function. However, with the proliferation of personal computers, desktop publishing software, network computing, and high resolution color graphics, documents are increasingly being created, stored and transmitted digitally, thereby increasing the need for digital document reproduction and printing.

Digital documents have also become increasingly complex and typically include digital text, line art or photographic images. In order to process these documents, digital document products rely upon a core set of imaging software and supporting electronics collectively known as a digital imaging controller. A digital imaging controller may be integrated with a digital document product in a variety of configurations:

embedded, where it resides completely inside the imaging device,

attached, where it resides outside the imaging device but is physically attached to it, and

stand-alone, where it resides completely outside the imaging device.

To date, the majority of embedded imaging systems have been developed and produced internally by digital document product manufacturers such as Hewlett-Packard, Xerox, and Canon, whereas attached and stand-alone imaging controllers have, for the most part, been developed by third party suppliers. Based primarily on International Data Corporation ("IDC") projections, the Company estimates that the total worldwide digital document hardware market (defined as worldwide color and monochrome laser printers, MFPs, single function digital copiers, and wide format printers) will be approximately $44 billion in 2005. The Company also estimates that its core color and monochrome printer and MFP market (defined as monochrome laser devices 14 pages per minute and faster and color laser devices 10 pages per minute and faster) includes some of the fastest growing segments for its controller and licensing products. IDC projects that the worldwide color above 10 pages per minute and monochrome above 14 pages per minute printers and MFPs will be $33 billion in 2005 and grow at a compound annual growth rate of 5% from 2004 to 2008. IDC forecasts that unit shipments of worldwide monochrome laser MFP devices 14 pages per minute and faster will grow at a compound annual rate of 13% from 2004-2008, and that unit shipments of worldwide color laser MFP devices 10 pages per minute and faster will grow at a compound annual growth rate of nearly 20%

from 2004 to 2008. The market value for the latter segment will grow at a compound annual growth rate of greater than 11% during that period, to approximately $10 billion by 2008. The Company is targeting this segment with its new products.

Developments in the Digital Document Products Market

Rapid changes in technology and end-user requirements have created challenges for digital document product manufacturers, particularly in the area of digital imaging systems. These changes include the increased demand for higher performance products at lower prices, the demand for color imaging, the emergence of MFPs, the increased role of networking, and the emergence of Internet printing standards.

Demand for higher performance at lower prices. Like other high technology markets, the digital document products market is under constant pressure to offer higher performance products and higher quality solutions at prices that are equivalent to or lower than previous levels. Digital imaging companies are employing a variety of software and hardware technologies in order to process greater volumes of data in cost effective ways. As end users demand higher levels of print performance and quality, digital imaging systems must increase in sophistication without becoming prohibitively expensive. The Company' s high performance color technologies and the Company' s approach to low cost application of these technologies address this market need.

Demand for color imaging. Market research indicates that the desire for cost effective color printing in the office is increasing and end users are demanding color printing at monochrome speeds and prices. Digital document product manufacturers are addressing the performance issue with more sophisticated imaging devices that are capable of printing multiple colors concurrently (commonly called "tandem" print engines), which in turn require more sophisticated digital imaging systems to supply them with print data. An entire new market is emerging for products that offer "convenience" color printing in the office and Enterprise. These products are designed to replace their monochrome equivalents at competitive price points with affordable total cost-of-ownership. The Company believes its new *Peerless Sierra Technologies* is ideally suited to help Peerless' OEMs and channel partners bridge the gap between monochrome and color digital imaging.

Emergence of multifunction products. The advent of MFPs has eroded the boundaries between the previously distinct printer, copier, fax and scanner market sectors. MFPs offer several functions, (i.e., copying, printing, emailing, scanning, and faxing) in one product. MFPs range from small home products to large high-speed office devices. Most of the largest vendors in the printer, copier and fax markets have now introduced MFPs, which has required each vendor to broaden its imaging expertise. At the same time, the need for concurrent processing of multiple digital document product functions has created the need for real-time, multitasking operating system support. *Peerless Sierra Technologies* was designed to address the complex requirements of driving and managing these richly featured MFP devices.

Increased role of networking. Within the office environment, digital document products are increasingly being deployed in a networked configuration. Because multiple local area network protocols and network operating systems are deployed in the corporate network environment, networked digital document products must support a broad array of networking technologies in order to maximize accessibility by various user groups. The network environment is also changing rapidly and becoming increasingly complex, with a growing requirement for remote network management that extends across local area networks, wide area networks, the Enterprise information technology ("IT") environment and the Internet. A key indicator of the growing network management requirements is the increase in the deployment of directory based management systems that consolidate information about all network resources and users in a centrally managed directory such as Microsoft Active Directory or Novell Directory Services. The Company' s core networking technology, the *Peerless Software Print Server* ("SPS") has been completely integrated into its family of controller products and is also available to its customers as a stand-alone *software development kit* ("SDK"). The SPS SDK is often considered one of the most complete networking solutions in the imaging industry.

In addition, because the majority of office digital document products are networked, the image processing intelligence may be partitioned and located anywhere within the network: at the site of document or image origination, at a server, or, as is typically the case today, inside the digital document product itself. In some instances, such as when printing to a remote location, it can be advantageous to perform image pre-processing and compression at the document origination site prior to transmission over usage-sensitive or congested facilities. In other instances, such as when printing from a graphics workstation, it can be advantageous to perform most of the image processing at the printer in order to offload a host computer that is under a heavy workload. In order to accommodate the emerging needs of the networked office environment, an optimal digital imaging system should employ a modular architecture capable of serving and managing distributed corporate resources.

Growing need for device and document management. Shared imaging devices on a network require greater levels of administrative control than stand-alone devices. Users and administrators should be able to discover printing services on a network, and a well designed imaging device should be able to "advertise" its capabilities. Systems that are capable of processing a high volume of print jobs originating from a variety of clients are expected to report back considerable detail about those jobs for accounting purposes and to alert remote users about error conditions that require human intervention. Such systems are often capable of holding documents for printing at a later time or routing documents to other parts of the network for additional processing. Document security is also a paramount concern in the corporate market and manufacturers are researching improved ways to protect document security.

Change in market patterns of OEM demand. There has been a general decline in the rates of growth for the monochrome work group printer and copier market segments in which Peerless, in the past, has been primarily engaged. While the markets for these products have continued to grow in absolute numbers, the rates of growth have declined. With the decline in the rates of growth, the OEMs that produce products in these markets have reacted by engaging in internal controller development and consolidating through mergers and acquisitions. In addition, the OEMs are now introducing new product platforms and engines at a slower rate than they had in the past.

Technology

In response to the challenges and demands upon digital document manufacturers, the Company continues to develop proprietary technologies for the digital imaging and digital document marketplace that are designed to provide meaningful improvements in performance, cost and time-to-market for Peerless' OEM customers. The Company's traditional proprietary object-based imaging system reduces the size of digital document imaging files with virtually no loss of visual quality. This proprietary technology enables the Company's OEM customers to increase print quality and speed, and reduce memory cost while eliminating or reducing the need for incremental compression technology. When optimized, this component of the digital imaging system can provide significant cost savings and performance differentiation to digital document product manufacturers. The Company incorporates complementary technologies, or makes its technologies compatible with third party technologies, in order to provide its customers with a more comprehensive imaging solution.

Over the past year, Peerless has developed new high performance color printing and MFP technologies under the umbrella of its *Peerless Sierra Technologies* architecture. These new technologies enable the Company to provide products and offerings in previously unreachable markets within the Enterprise, such as the *convenience color* market for the walk-up end user.

Object-based image processing. While developing *Peerless Sierra Technologies*, the Company made advances in its proprietary object-based image processing technology. These advances improve the rendering quality of the Peerless color processing pipeline. They take advantage of the increased computing power of modern microprocessors to perform complex calculations that enhance the fidelity of the printed output with respect to the original digital document. Enhancements associated with these advances include a new patent pending *lossless compression* algorithm and sophisticated methods for identifying different graphical objects after the page image has been fully rendered.

The Company's object-based image processing technology provides more significant benefits as the image processing workload increases, which occurs with increased resolution or a transition from monochrome to color printing.

Systems architecture. The Company has extended its core systems architecture to include new features and functions, such as support for its new PCL-XL 3.0 emulation, PeerlessPrint®, and the latest version of Adobe PostScript 3, a fast tandem print engine interface, and advanced networking. Additional architectural improvements occurred during the development of *Peerless Sierra Technologies.* This new architecture takes advantage of modern hardware and software design methodologies that have allowed the Company to establish a modular approach to its architecture and support such functions as job management, color management, networking, scanning and faxing. This modular approach has enabled the Company to have standardized interfaces for its family of products and further allows for its imaging solutions to be ported to a variety of platforms, printer languages and applications. One significant advantage of this system' s modularity is that the standardized PeerlessPage interface provides the ability to support multiple printer languages. The PeerlessPage object-based imaging modules are both platform and device-independent, and are able to accommodate a variety of print engines and controller architectures. An important example of this system' s portability is the fact that prototype versions of *Peerless Sierra Technologies* were designed to run on top of the VxWorks operating system while current product quality versions are designed to run on top of the Linux operating system. The *Peerless Sierra Technologies* architecture is capable of supporting very high resolution monochrome and color digital documents and products.

A key component of the architectural philosophy underlying *Peerless Sierra Technologies* is a completely open controller design in the form of an XML-based application interface called the *Open Workflow Architecture* ("OWA"). The OWA allows third party application developers virtually instant access to all the features and functions embodied in a *Peerless Sierra Technologies* based controller using modern, standardized interface and communications methods.

Technology partners. The Company has established relationships that permit it to offer its customers complementary technologies developed by various technology partners, including Adobe and Novell. Adobe has been a development partner with Peerless since 1992 and the relationship has grown with each new application of Peerless and Adobe technologies. In 1999, Adobe and Peerless entered into a PostScript Software Development License and Sublicense Agreement that expanded the application and integration of the respective technologies. The Company' s relationship with Adobe permits the Company to offer a convenient and optimized Adobe PostScript-enabled solution, as well as directly sublicense PostScript to its OEM customers. Peerless has also invested in the development of PSIP' s *VersaPage* API technology which is designed to better enable OEMs to integrate Adobe PostScript into their products.

Peerless also has a strategic relationship with Novell. The relationship covers networking and device management software licenses for imaging devices across the Novell Directory Services server environment, which includes Novell Embedded Systems Technology Server Software. The Company' s agreement with Novell enables Peerless to directly sublicense embedded directory and network services technology for multiple market segments, allowing Peerless to offer greater functionality for all network devices, extending the Company' s reach from digital output systems to other devices such as set top boxes and cable modems. Peerless also provides custom engineering to OEMs for implementation of Novell Distributed Print Server gateways.

The Company has also established semiconductor agreements with some of the leading developers and manufacturers of reduced instruction set computer ("RISC") microprocessors including IBM and NEC. These relationships have allowed the Company' s semiconductor partners to offer integrated processor and co-processor solutions, which combine the Company' s basic imaging technology with an industry-standard microprocessor.

Strategy for Business

The Company' s overall objectives for growth in the imaging business are to develop more diverse distribution channels for its products, to broaden the number of supported imaging devices to include higher margin color copier and printing devices, to reduce the time-to-market of Peerless-based products through the increased use of standardized PC hardware and software tools, and to increase its focus on developing applications that perform job, document, and content management. The Company' s imaging software is portable to a wide range of technology platforms, and the Company can take advantage of that fact to move its product line both up market and down market in relation to its traditional market presence. The Company has devoted research and development resources on its line of applications to support an end-to-end solution for ease of use during the printing process. The key to the Company' s overall technology strategy is to offer its customers products, services, and time-to-market advantages that exceed what they are capable of doing without having Peerless as a supplier or partner.

The Company is focused on the following growth strategies:

Aggressive development of new technologies. The Company has invested substantially in developing new products for the imaging marketplace. Despite reducing its operating expenses significantly, Peerless has continued to invest in research and development. The Company' s strategy is to continue to introduce imaging technology innovations designed to increase performance, reduce cost and address a broader range of emerging digital document product requirements, including MFP and color applications. The Company is seeking to further develop its intellectual property in embedded imaging for various equipment applications and technologies, expanding their application into attached and server based applications.

Increased packaging of Company technologies for licensing as SDKs. As a result of the development of the modular *Peerless Sierra Technologies* and its enhancement of its existing monochrome capabilities, the Company is packaging its technologies in SDKs allowing OEMs to pick and choose the components that they need to address specific product development needs.

Develop and expand relationships with key industry participants. The Company has established relationships with leading color and monochrome printer industry companies, such as Canon, KonicaMinolta, Kyocera/ Mita, Lenovo, Oki Data, Panasonic, Ricoh, and Seiko Epson (collectively, “OEM Partners”). Peerless seeks to expand its relationships with its OEM Partners by offering a broad range of solutions for additional digital color and monochrome devices produced by its OEM Partners. The Company is also establishing relationships with other digital copier and printer companies.

Leverage technical expertise to expand products and markets. Peerless has an experienced team of technology experts with backgrounds in image processing, compression, language interpreters, printer drivers, networking, ASIC and hardware engineering, software engineering, color reproduction, real-time operating systems and systems integration. Applying its expertise in these areas allows the Company to continue to expand the technical superiority of its products and gain access to new markets.

Develop and enhance strategic relationships in the digital document market. The Company intends to develop and enhance its relationships with key participants in the digital document product market. For example, the Company has strategic relationships with industry leaders such as Adobe, Novell, and IBM.

Expand sales channels. Early in fiscal year 2004, the Company hired key sales and marketing professionals to focus on channel expansion. The Company expects to leverage its new technologies and industry expertise to provide compelling solutions to distributors, value added resellers, system integrators and OEM sales operations. Peerless continues to engage in discussions with several large distribution and service organizations.

Expand geographical presence and market reach. Peerless has established relationships with co-development firms such as Metatechno and NTL of Japan and WeSoft of Hong Kong. The Company has begun to market and sell its products into the Peoples' Republic of China and Taiwan.

Develop sales of new hardware products. The development of the first *Peerless Sierra Technologies* based controller was completed in fiscal year 2005, followed by its launch into the marketplace in the fourth quarter of fiscal year 2005. The Company believes that the introduction of the controller will result in future sales to OEMs for the use of this technology.

Products and Solutions

The main source of Peerless' revenues comes from its licensed software-based imaging and networking systems for the digital document product marketplace. The Company' s technology and engineering services provide advanced imaging solutions that enable the Company' s OEM customers to develop digital printers, copiers and MFPs cost effectively. The Company delivers its products to its OEM customers in multiple ways, including: licensing of the Company' s SDKs that provide imaging and networking technology for the OEM' s internal product development; turnkey product development whereby the Company provides the technology and the additional engineering services necessary to integrate the appropriate technology into a complete imaging system solution optimized to the OEM' s specific requirements; and a co-development relationship that combines the licensing of Peerless technology with joint Peerless or third party co-development firms and OEM engineering resources.

Peerless' technology allows copiers and printers to be shared across work groups, a distributed enterprise and the Internet. The Company' s products support a wide range of digital printing devices for both direct connect and networked configurations, including: desktop color printers; digital black and white copiers; digital black and white laser printers; digital color copiers and language-enabled (i.e., PostScript, PeerlessPrint®5C, PeerlessPrint®6, or PeerlessPrint®7), as well as raster-based desktop inkjet printers. Peerless' raster-based solutions (often referred to as "GDI" or "Windows" printing technology) are marketed under the trade name AccelePrint®, and are capable of driving a variety of lower cost monochrome and color devices, including both printers and copiers.

In addition to existing products, Peerless is developing new controller products and solutions targeted for direct sales to the distribution channels. These markets include OEM distributors and companies that sell OEM engines and peripherals which in some cases are privately branded. In the fourth quarter of fiscal year 2005, the Company began shipping its new Everest controller products to selected OEM dealers of MFPs.

Peerless also announced the release of its PeerlessPrint®7 SDK, which delivered improvements in the image quality of the printer control language. PeerlessPrint®7 includes PeerlessColortm, a new International Color Consortium ("ICC")-based color workflow tool and PeerlessTrappingtm color image enhancement software.

Subsequent to the January 31, 2005, the Company signed a Memorandum of Understanding (MOU) with Kyocera Mita Corporation to provide engineering services in the development of several new color products. The binding agreement is for three years, with payments of $2 million dollars per quarter over that period.

Architecture. Peerless' high performance architecture includes all the components necessary to construct a world class controller supporting color printing, scanning, and faxing, with extensions to support the addition of value-added functions such as integrated copying. The architectural components consist of a complete object-based imaging system capable of rendering a variety of document formats into high fidelity printed output, as well as a print engine driver, object-based image processing model, graphics library, color management, font management, hard disk management, print job management, distributed scanning, high speed faxing, user control panel interface and a full suite of direct and networked connectivity options. These components are accessible to other networked devices through Peerless' OWA, which provides the interfaces for device status and control using standard XML processing.

Page Descriptor Languages ("PDL"). Peerless provides OEMs with support for the most widely used and standard PDLs, namely Adobe' s PostScript Software and Hewlett-Packard' s Printer Control Language ("PCL"). The Company offers PeerlessPrint® technology, which emulates Hewlett-Packard' s PCL. The current level of emulation coincides with Hewlett-Packard' s PCL-XL Protocol 3.0 specification.

PDL printer drivers. The role of the PDL printer drivers is to convert user application data into device specific commands. The Company' s printer drivers consist of the necessary software to run the targeted print device, as well as translation software running on the workstation computer. This software translates the document from device independent data into device specific data and a format suitable for network transmission and interpretation at the printer. The latest versions of the Company' s printer driver software incorporate advanced color management features that have been designed with ease-of-use for the office knowledge worker in mind.

ASICs. The Company' s ASICs provide an integrated chip implementation of key components of its imaging technology. Peerless has licensed its proprietary ASIC designs to semiconductor manufacturers, such as IBM, Motorola and NEC, which gives them the right to manufacture and sell these ASICs directly to digital document product manufacturers. The Company uses a "fabless" model to sell its devices, either directly or through its distributor in Japan.

Job management software. Peerless job management software enables print job management from different computer platforms through OEM, third party, Web or Peerless developed user interfaces. This software enables remote access to print queues so users or administrators can track and control their print jobs.

Color management software. Peerless color management software is based on the use of industry standard ICC profiles, which ensures the highest degree of fidelity and user-specifiable flexibility when rendering digital documents on color output devices. This software supports four different *rendering intents*, Perceptual, Saturation, Relative Colorimetric, and Absolute Colorimetric, which allows the end user to select the appropriate rendering mode for diverse document types such as reports, presentations, and photographs.

Engineering services. For those OEMs that wish to outsource the development of some or all of the imaging system for a digital document product, the Company offers engineering services. These include controller design and custom engineering for vendor-specific features that complement the Company' s standard imaging technology. The Company has assembled an experienced team of technical personnel with backgrounds in image processing, compression, language interpreters, printer drivers, networking, ASIC and hardware engineering, software engineering, color reproduction, real-time operating systems and systems integration. The resulting systems conform to accepted standards, ranging from networking protocols to language syntaxes and color processing methodologies.

Networking technology. Peerless supports an array of networking protocols allowing its OEM customers to address a broad range of end-user networking requirements and scenarios. The Peerless network software product family encompasses network printing and scanning, internet fax, and network management features including Simple Network Management Protocol, Directory Services, and Web-based services. Through integration of industry standard network management agents, the software can integrate seamlessly into existing organizational network management applications. Peerless is also actively engaged in addressing advanced security requirements that are becoming mandatory for addressing both health provider and government-related industries. Security of both the network and applications will open up new markets and opportunities for Peerless network technology going forward.

Certification services. To complement the licensing of PostScript that the Company provides through its relationship with Adobe, Peerless provides engineering support to PostScript licensees to certify the OEM' s PostScript implementation. This service includes support for all phases of the certification process and reduces the time to achieve final product certification.

Complete controllers. Based on its *Peerless Sierra Technologies*, the Company' s new Everest controller offers multifunction capabilities, supporting high-performance, simultaneous color printing, scanning, and faxing. During fiscal year 2005, the Company formally launched the controller, shipping to select dealers of the Konica Minolta bizhubtm C350 color MFP. The Company has an arrangement with a contract manufacturer to manufacture and ship the controllers.

Customers and Markets

Customers

The Company currently derives substantially all of its revenues from direct sales to digital document product OEMs. Four of the Company' s customers, Konica Minolta, Novell, Seiko Epson, and Kyocera Mita each generated more than 10% of the Company' s total revenues for fiscal year 2005. Revenues from the Company' s top three customers accounted for 53%, 61%, and 55% of the Company' s total revenues for fiscal years 2005, 2004, and 2003, respectively. Although the Company has expanded and diversified its customer base through focused sales efforts and acquisitions, the Company anticipates that its future revenues may be similarly concentrated with a limited number of customers. The Company' s largest customers vary to some extent from year to year as product cycles end, contractual relationships expire and new products and customers emerge. Many of the engineering services and a number of licensing arrangements with the Company' s customers are provided on a project-by-project basis, are terminable with limited or no notice, and in certain instances are not governed by long-term agreements. Because a limited number of customers generate a large percentage of the Company' s revenues, any loss of these customers would have a material adverse impact on the Company' s results of operations. See "Certain Factors and Trends Affecting Peerless and Its Business − Peerless relies on relationships with certain customers and any adverse change in those relationships will harm the Company' s business," for a discussion of the Company' s reliance on a limited number of customers.

As discussed previously, there has been a general decline in the rates of growth for the monochrome work group printer and copier market segments in which Peerless is engaged. For those product platforms that do go forward for development and customer introduction, the OEMs, in a number of instances, have not selected the Company' s solutions. This occurred in some cases because the OEMs perceived that the Company' s solutions did not meet their technical requirements. In other cases it occurred because the OEMs either developed the technology themselves or utilized lower cost offshore software competitors. However, the Company has begun to focus on higher growth segments such as color printing and color MFP markets with the OEMs and with companies in the distribution channels.

Markets

Segments. The Company sells its products and services to OEMs which produce products for the enterprise and office sector of the digital document product market, which is characterized by digital document products ranging in price from approximately $1,000 to in excess of $40,000 each. These products typically offer high performance differentiated by customized features. In many cases, digital document product manufacturers demand turnkey, customized digital imaging solutions that include imaging software, controller design and network interface card design. As a result of these unique requirements, Peerless typically addresses the office sector of the digital document product market via direct OEM relationships with individual digital document product manufacturers. The Company' s major customers in the office market in the fiscal year 2005 included KonicaMinolta, Seiko Epson, Kyocera Mita, Oki Data, Canon, Panasonic, and Riso.

Geography. Since the majority of the Company' s OEM customers are comprised primarily of companies headquartered in Japan, revenues from customers outside the United States accounted for 85% of the Company' s total revenues in fiscal years 2005, and 87% in fiscal years 2004 and 2003. Further, the Company expects that sales to customers located outside the United States may increase in absolute dollars in the future. These customers sell products containing Peerless' technology primarily in the North American and European marketplaces. See "Management' s Discussion and Analysis of Financial Condition and Results of Operations" for further discussion on Asian markets.

All of the Company' s contracts with international customers are, and the Company expects that in the future will be, denominated in U.S. dollars. As a result, the Company is currently not subject to foreign currency transaction and translation gains and losses. However, see "Certain Factors and Trends Affecting Peerless and Its Business − The Company' s international activities may expose the Company to risks associated with international business."

Sales and Marketing

The Company markets its products to OEMs that sell digital document products to the worldwide market. The Company directs most of its sales efforts through its headquarters in California and its subsidiary, Peerless K.K., in Japan. Sales to European digital document product manufacturers are conducted out of the Company' s California headquarters. The Company has extended its sales efforts to include distributors, value added resellers, system integrators, and geographically based OEM sales operations. The Company has invested in an additional regional sales presence on the east coast of the United States. The Company markets its technology directly to OEMs, as well as through focused trade relations and branding programs. Direct

OEM marketing consists of focused public relations activities and the development of sales collateral, mailers, trade show attendance, and sales support. The Company has devoted increased time and resources to increasing Peerless' presence in media accessed by OEM customers. The Company directs public relations and product branding programs toward building awareness of the Peerless brand name.

With the launch of the Company' s Everest controller there has been an expansion of Peerless' sales and marketing efforts to include the Konica Minolta dealer network. Focused sales and training efforts have been applied to this network to create dealer awareness of the performance capabilities of the Everest controller and the necessary steps to install the controller. Peerless has also retained on a commission basis four additional sales representatives to sell to the Konica Minolta dealers.

Product Development and Engineering Services

The Company' s product development activities are located at two sites, El Segundo, California, and Kent, Washington. These activities primarily consist of new product development, enhancement of existing products, product testing, and technical documentation. The Company' s engineering is focused on two primary areas: research and development, which focuses on development and enhancement of the Company' s products and core technologies; and engineering services, which focuses on customized customer design activities.

The Company' s engineers work closely with OEMs that desire a turnkey solution, developing customized interfaces and applications specific to individual OEMs. The Company typically receives a fee for such engineering services. To further support the development of technology and products for the Company' s OEMs, Peerless has established co-development relationships with Metatechno, a Japan based company that provides product development support for some of the Peerless OEMs in Japan, and WeSoft, a Hong Kong based company that currently supports development and testing of customer projects. The Metatechno relationship provides local technical support to Peerless OEMs and has proved valuable in addressing the cultural and language differences. In addition, the Company has established a relationship with NTL of Japan, to focus on the integration of server-based development. Peerless expects that WeSoft will play a similar role as Peerless addresses the Southeast Asia market, including China.

Intellectual Property and Proprietary Rights

The Company' s success is heavily dependent upon its proprietary technology. To protect its proprietary rights, the Company relies on the combination of patent, copyright, trade secret and trademark laws. The Company also enters into nondisclosure agreements and other contractual provisions and restrictions.

The Company has fifty-five patents and patents pending on a world-wide basis. As of January 31, 2005, the Company had 11 issued U.S. patents, 8 pending U.S. patent applications and various foreign counterpart patents and applications in the European Patent Office, Japan, Hong Kong, Taiwan, China, Australia, India, and Korea. The issued patents and applications relate to techniques developed by the Company for generating output for continuous synchronous raster output devices, such as laser printers, compressing data for use with output devices, filtering techniques for use with output devices and communicating with peripheral devices over a network.

There can be no guarantee that the patents held by the Company will not be challenged or invalidated, that patents will be issued for any of the Company' s pending applications, or that any claims allowed from existing or pending patents will be of sufficient scope or strength (or issue in the countries where products incorporating the Company' s technology may be sold) to provide meaningful protection or any commercial advantage to the Company. In any event, effective protection of intellectual property rights may be unavailable or be limited in certain countries. The status of United States patent protection in the software industry continues to evolve as the United States Patent and Trademark Office grants additional patents in this area. Patents have been granted to fundamental technologies in software after the development of an industry around such technologies, and patents that relate to fundamental technologies related to the Company' s business may be issued to third parties.

As part of its confidentiality procedures, the Company enters into nondisclosure agreements with its employees, consultants, OEMs and strategic partners and takes further affirmative steps to limit access to and distribution of its software and other proprietary information. Despite these efforts and in the event such agreements are not timely made, complied with or enforced, the Company may be unable to protect its proprietary rights. In any event, enforcement of the Company' s proprietary rights may be very expensive. The Company' s source code also is protected as a trade secret. However, the Company from time to time licenses its source code to OEMs pursuant to protective agreements, which subjects the Company to the risk of unauthorized use or misappropriation despite the contractual terms restricting disclosure, distribution, copying, and use. In addition, it may be possible for unauthorized third parties to obtain, distribute, copy, or use the Company' s proprietary information, or to reverse engineer the Company' s trade secrets.

As the number of patents, copyrights, trademarks and other intellectual property rights in the Company' s industry increases, products using the Company' s technologies increasingly may become the subject of infringement claims. There can be no assurance that third parties will not assert infringement claims against the Company in the future. Any such claims, regardless of merit, will be time consuming, result in costly litigation, cause product shipment delays, or require the Company to enter into unfavorable royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to the Company, or at all, which could have a material adverse effect on the Company' s operating results. In addition, the Company may initiate claims or litigation against third parties for infringement of the Company' s proprietary rights or to establish the validity of the Company' s proprietary rights. Litigation to determine the validity of any claims, whether or not such litigation is determined in favor of the Company, will result in significant expense to the Company and divert the efforts of the Company' s technical and management personnel from productive tasks. The Company may lack sufficient resources to initiate a meritorious claim. In the event of an adverse ruling in any litigation regarding intellectual property, the Company may be required to pay substantial damages, discontinue the use and sale of infringing products, expend significant resources to develop non-infringing technology, or obtain licenses to infringing or substituted technology. The failure of the Company to develop or license on acceptable terms a substitute technology, if required, could have a material adverse effect on the Company' s operating results. See "Certain Factors and Trends Affecting Peerless and Its Business − If Peerless fails to adequately protect the Company' s intellectual property or faces a claim of intellectual property infringement by a third party, Peerless could lose the Company' s intellectual property rights or be liable for damages."

Competition

The market for outsourced imaging systems for digital document products is highly competitive and characterized by continuous pressure to enhance performance, add functionality, reduce costs and accelerate the release of new products. The Company competes on the basis of a refreshed base of core technologies and new MFP technologies, plus technology expertise, product functionality, development time and price. The Company' s technology and services primarily compete with solutions developed internally by OEMs. Virtually all of the Company' s OEM customers have significant investments in their existing solutions and have the substantial resources necessary to enhance existing products and to develop future products. These OEMs have or may develop competing imaging system technologies and may implement these systems into their products, thereby replacing the Company' s current or proposed technologies, eliminating the need for the Company' s services and products and limiting future opportunities for the Company. In fact, OEMs have increasingly been shifting away from third party solutions in favor of in-house development. Therefore, the Company is required to persuade these OEMs to outsource the development of their imaging systems and to provide products and solutions to these OEMs that favorably compete with their internally developed products. The best way to accomplish this continues to be to offer products, services, and time-to-market advantages that exceed what the OEMs are capable of doing using their own internal resources. The Company also competes with software and engineering services provided in the digital document product marketplace by other systems suppliers to OEMs. In this regard, the Company competes with, among others, Destiny Technology Corporation, EFI Electronics Corporation, Global Graphics Software Ltd., Software Imaging, and Zoran Corporation (formerly Oak Technologies).

As the industry continues to develop, the Company expects that competition and pricing pressures will increase from OEMs, existing competitors and other companies that may enter the Company' s existing or future markets with similar or substitute solutions that may be less costly or provide better performance or functionality. The Company anticipates increasing competition for its color and multifunction products, particularly as competitors develop and introduce products in this market. Some of the Company' s existing competitors, many of its potential competitors and virtually all of the Company' s OEM customers have substantially greater financial, technical, marketing and sales resources than the Company. In the event that price competition increases, competitive pressures could cause the Company to reduce the amount of royalties received on new licenses and to reduce the cost of its engineering services in order to maintain existing business and generate additional product licensing revenues. This could reduce profit margins and result in losses and a decrease in market share. No assurance can be given as to the ability of the Company to compete favorably with the internal development capabilities of its current and prospective OEM customers or with other third party imaging system suppliers, and the inability to do so would have a material adverse effect on the Company' s operating results.

Employees

As of April 26, 2005 the Company had a total of 96 employees plus 9 who performed efforts as consultants and contractors. None of the Company' s employees is represented by a labor union, and the Company has never experienced any work stoppage. The Company considers its relations with its employees to be good.

Certain Factors and Trends Affecting Peerless and Its Business

If Kyocera Mita Corporation and the Company do not enter into definitive agreements in support or replacement of the Memorandum of Understanding (MOU) between the companies, it may harm the Company' s financial results.

Peerless and Kyocera Mita may never come to agreement on the terms of definitive agreements regarding the development of Kyocera Mita products by Peerless or enter into definitive agreements relating to their relationship described in the MOU. If the parties do not enter into definitive agreements, the relationship between the parties may be limited to the MOU. Even if Peerless and Kyocera Mita do enter into definitive agreements, the terms of the definitive agreements may be less beneficial to Peerless than the terms set forth in the MOU. If the parties do not enter into definitive agreements or the terms of the definitive agreements are less beneficial to Peerless than the terms set forth in the MOU, it may harm the Company' s financial results.

Under new regulations required by the Sarbanes-Oxley Act of 2002 (SOX), an adverse opinion on internal controls over financial reporting could be issued by our independent registered public accounting firm, and this could have a negative impact on our stock price.

Section 404 of SOX requires that the Company establish and maintain an adequate internal control structure and procedures for financial reporting and assess on an on-going basis the design and operating effectiveness of the internal control structure and procedures for financial reporting. The Company' s independent registered public accounting firm is required to attest audit both the design and operating effectiveness of the Company' s internal controls and management' s assessment of the design and the effectiveness of its internal controls. If the Company' s aggregate market value exceeds $75 million as of July 31, 2005 the attest audit by the Company' s independent registered public accounting firm would be required for fiscal year end January 31, 2006. If the aggregate market value is lower than $75 million the attest audit would not be required until fiscal year end January 31, 2007. The Company' s aggregate market value as of April 29, 2005 was approximately $49 million. Although no known material weaknesses exist at this time, it is possible that material weaknesses may be found in the future. If the Company is unable to remediate the weaknesses, the independent registered public accounting firm would be required to issue an adverse opinion on the Company' s internal controls.

Because opinions on internal controls have not been required in the past, it is uncertain what impact an adverse opinion would have upon the Company' s stock price.

Recent and proposed regulations related to equity incentives could adversely affect our ability to attract and retain key personnel.

Since its inception, the Company has used stock options and other long-term equity incentives as a fundamental component of its employee retention packages. The Company believes that stock options and other long-term equity incentives directly motivate its employees to maximize long-term stockholder value and, through the use of vesting, encourage employees to remain with Peerless. The Financial Accounting Standards Board has announced changes that, when implemented, will require the Company to record a charge to earnings for employee stock option grants and issuances of stock under employee stock purchase plans. This regulation could negatively impact the Company' s results of operations. In addition, new regulations implemented by the Nasdaq National Market requiring shareholder approval for all stock option plans could make it more difficult for us to grant options to employees in the future. To the extent that new regulations make it more difficult or expensive to grant options to employees, the Company may incur increased costs, change its equity incentive strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect the Company' s business.

The impact of Microsoft' s "Longhorn" operating system could have an adverse impact on the Company' s future licensing revenues.

Among the changes announced for Microsoft' s "Longhorn" operating system are fundamental changes to the printing and networking subsystems within the operating system. Of particular relevance to Peerless is Microsoft' s development of a new page description language (PDL) and peripheral device connectivity methods, the format of which would be licensed by Microsoft on a royalty-free basis to both OEMs and 3rd party technology providers such as Peerless. Should Peerless fail to support these technologies on a timely basis, or should OEMs decide to support these technologies on their own without use of Peerless' products, it could have an adverse impact on the Company' s potential licensing revenues from these enhanced products. In addition, to the extent that Peerless' current PDL products are perceived as being gradually rendered obsolete over the long term by these new Microsoft technologies, it could have an adverse impact on Peerless' ability to generate new sales of its current PDL products.

The Company' s near term revenue may drop as a result of the timing of licensing revenues and the reduced demand for its existing monochrome technologies.

The Company has traditionally generated its revenue from the licensing and sale of monochrome solutions to OEMs. While the Company is continuing to provide monochrome solutions to OEM customers and continuing to seek out additional distribution channels and customers for its monochrome solutions, the Company is increasing the focus of its research and development and marketing efforts on its *Peerless Sierra Technologies* product line of high performance, high speed, color imaging solutions. Until the Company' s *Peerless Sierra Technologies* becomes accepted in the marketplace − if such technology does become accepted in the marketplace − the Company' s overall license revenue may stagnate or even decrease. If the Company' s revenue stagnates or decreases, the value of the Company' s securities may be adversely affected.

If the Company is unable to achieve its expected level of sales of Peerless Sierra Technologies on a timely basis, the Company' s future revenue and operating results may be harmed.

The Company' s future operating results will depend to a significant extent on the Company' s success of its new *Peerless Sierra Technologies.* The Company has spent a significant amount of time and capital developing its new *Peerless Sierra Technologies.* Any material problems associated with the launch of channel sales or a delay in licensing its *Peerless Sierra Technologies* in the future could harm the Company' s financial results.

If the marketplace does not accept Peerless' new Peerless Sierra Technologies, the Company's future revenue and operating results may be harmed.

Peerless Sierra Technologies may not be accepted by the marketplace for many reasons including, among others, incompatibility with existing or forthcoming systems, lack of perceived need by customers, uncertainty whether the benefits exceed the cost, the availability of alternatives, and unwillingness to use new or unproven products. If the marketplace does not accept the *Peerless Sierra Technologies* or if the marketplace takes additional time to accept the *Peerless Sierra Technologies* than Peerless is expecting, the Company' s future revenues and operating results may be harmed.

The Company's forecasts for its Everest controller may not be realized, and losses for the disposition of excess inventories may result.

The Company plans to maintain inventories to fill orders for its Everest controller products on a timely basis. If the forecasts of expected orders are not achieved, inventory levels may be too high, and if inventories cannot be liquidated through product orders, the Company may be required to write down the value of any excess unrealizable inventories, which would negatively impact the Company' s gross margin.

The Company's existing capital resources may not be sufficient and if Peerless is unable to raise additional capital, the Company's business may suffer.

The Company' s cash and short-term investment portfolio was $6.5 million at January 31, 2005 and the current ratio of current assets to current liabilities was 1.8:1. For the fiscal year ended January 31, 2005, Peerless' operations used $2.7 million in cash.

The Company' s principal source of liquidity is the Company' s cash and cash equivalents and investments, which, as of January 31, 2005 were approximately $6.5 million in the aggregate. If Peerless does not generate anticipated cash flow from licensing and services, or if expenditures are greater than expected, Peerless most likely will reduce discretionary spending, which could require a delay, scaling back or elimination of some or all of the Company' s development efforts, any of which could have a material adverse effect on the Company' s business, results of operations and prospects. Furthermore, if Peerless experiences negative cash flows greater than anticipated, and Peerless is unable to increase revenues or cut costs so that revenues generated from operating activities are sufficient to meet the Company' s obligations, Peerless will be required to obtain additional capital from other sources. Such sources might include issuances of debt or equity securities, bank financing or other means that might be available to increase the Company' s working capital. Under such circumstances, there is substantial doubt as to whether Peerless would be able to obtain additional capital on commercially reasonable terms or at all. The inability to obtain such resources on commercially acceptable terms could have a material adverse effect on the Company' s operations, liquidity and financial condition, the Company' s prospects and the scope of strategic alternatives and initiatives available to the Company. Peerless recently established a credit facility with its bank that allows for borrowing against outstanding receivables. The credit facility generally only provides coverage for short-term working capital needs and the Company may require additional long-term capital to finance working capital requirements.

Peerless has a history of losses.

Peerless was unprofitable in fiscal year 2005. There is no assurance that the Company will be profitable at any time in the future.

Future losses will deplete the Company' s capital resources. The factors noted in this section, "Certain Factors and Trends Affecting Peerless and Its Business," have had and may continue to have a material adverse effect on the Company' s future revenues and/or results of operations.

The future demand for the Company's current products is uncertain.

Peerless' monochrome technology and products have been in the marketplace for an average of 29 months as of January 31, 2005. This is a 21% increase from the average of 24 months that the Company' s products had been in the marketplace as of January 31, 2004. The increase in the average age of current technology and products in the marketplace reflects the aging of the Company' s monochrome technology and products. Although Peerless continues to license the Company' s current technology and products to certain OEMs, there can be no assurance that the OEMs will continue to need or utilize the current technology and products the Company offers.

Peerless relies on relationships with certain customers and any adverse change in those relationships will harm the Company' s business.

A limited number of OEM customers continue to provide a substantial portion of Peerless' revenues. Presently, there are only a small number of OEM customers in the digital document product market to which the Company can market its technology and services. Therefore, the Company' s ability to offset a significant decrease in the revenues from a particular customer or to replace a lost customer is severely constrained.

During fiscal year 2005, four customers, KonicaMinolta Holdings Corporation, Novell, Inc., Seiko Epson Corporation, and Kyocera Mita Corporation each generated greater than 10% of the Company' s revenues and collectively contributed 63% of revenues. Block license revenues for the same time period totaled $12.8 million, or 56% of revenues. During fiscal year 2004, three customers, KonicaMinolta Holdings Corporation, Oki Data Corporation and Seiko Epson Corporation, each generated greater than 10% of the revenues, and collectively contributed 61% of revenues. Block license revenues during the same period were $16.0 million, or 63% of revenues.

Peerless relies on relationships with Adobe Systems Incorporated and Novell Inc., and any adverse change in those relationships will harm the Company' s business.

The Company has licensing agreements with Adobe Systems Incorporated and Novell Inc. to bundle and sublicense their licensed products with the Company' s licensed software. These relationships accounted for $10.2 million in revenues and an associated $4.1 million in cost of revenues during fiscal year 2005. Should the agreement with any of these vendors be terminated or canceled, there is no assurance that the Company could replace that source of revenue within a short period of time, if at all. Such an event would have a material adverse effect on the Company' s operating results.

The Company, as a sublicensor of third party intellectual property, is subject to audits of the Company' s licensing fee costs.

The Company' s licensing agreements that include third party intellectual property result in royalties contractually due and payable to the third parties. The rates are subject to interpretation of contract language and intent of the contracting parties, and may result in disputes as to the correct rates. Peerless is subject to audits of the Company' s data serving as the basis for the royalties due. Such audits may result in adjustments to the royalty amounts due.

The Company has negotiated with Adobe Systems Incorporated and Canon Inc. to remedy a contract dispute, which, if not remedied, could result in the loss of the Adobe agreement and harm to the Company' s business.

Peerless has negotiated with Canon Inc. regarding the PostScript sublicense agreement between Peerless and Canon executed as of April 1, 2001. The sublicense did not include several terms required to be included in all OEM sublicenses by Peerless' license with Adobe. Although Adobe has indicated to Peerless that it has no current intention to pursue claims for alleged breach of the Adobe Peerless PostScript Sublicensing Agreement, Adobe has not agreed to waive the requirement that the missing terms be included in the Canon sublicense. To date, Peerless has been unable to amend the Canon sublicense in a manner acceptable to both Canon and Adobe. Furthermore, there is no assurance that Peerless will be able to resolve the issues in a manner acceptable to both Adobe and Canon. Thus, Adobe may exercise its right to terminate its license agreement with Peerless and take other legal action against Peerless, if it so chooses. Termination of the Adobe agreement would have a material adverse effect on Peerless' future operating results. Approximately

31% of Peerless' revenue for the fiscal year ended January 31, 2005 and approximately 41% of Peerless' revenue for the fiscal year ended January 31, 2004 were derived from its licensing arrangement with Adobe Systems Incorporated. See "Peerless relies on relationships with Adobe Systems Incorporated and Novell Inc., and any adverse change in those relationships will harm the Company' s business."

Peerless may be unable to develop additional new and enhanced products that achieve market acceptance.

Peerless currently derives substantially all of its revenues from licensing and sale of the Company' s monochrome imaging software and products and the sublicensing of third party technologies. Peerless expects that revenue from imaging products will continue to account for a substantial portion of revenues during fiscal year 2006 and beyond. The Company' s future success also depends in part on the Company' s ability to address the rapidly changing needs of potential customers in the marketplace, to introduce high-quality, cost-effective products, product enhancements and services on a timely basis, and to keep pace with technological developments and emerging industry standards. The Company' s failure to achieve its business plan to develop and to successfully introduce new products and product enhancements in the Company' s prime markets is likely to materially and adversely affect the Company' s business and financial results.

If Peerless is not in compliance with the Company' s licensing agreements, Peerless may lose the Company' s rights to sublicense technology; the Company' s competitors are aggressively pursuing the sale of licensed third party technology.

Peerless currently sublicenses third party technologies to the Company' s OEM customers, which sublicenses account for a significant amount of the Company' s gross revenues. Such sublicense agreements are non-exclusive. If Peerless is determined not to be in compliance with the Company' s agreements with its licensors, Peerless may forfeit the Company' s right to sublicense these technologies. Likewise, if such sublicense agreements were canceled, Peerless would lose the Company' s right to sublicense the affected technologies. Additionally, the licensing of these technologies has become very competitive with competitors possessing substantially greater financial and technical resources and market penetration than Peerless. As competitors are pursuing aggressive strategies to obtain similar rights as held by Peerless to sublicense these third party technologies, there is no assurance that Peerless can remain competitive in the marketplace if one or more competitors are successful. See "The Company has negotiated with Adobe Systems Incorporated and Canon, Inc. to remedy a contract dispute, which, if not remedied, could result in the loss of the Adobe agreement and harm to the Company' s business."

The industry for imaging systems for digital document products involves intense competition and rapid technological changes, and the Company' s business may suffer if its competitors develop superior technology.

The market for imaging systems for digital document products is highly competitive and characterized by continuous pressure to enhance performance, to introduce new features and to accelerate the release of new products. Peerless competes on the basis of technology expertise, product functionality, development time and price. Peerless' technology and services primarily compete with solutions developed internally by OEMs. Virtually all of the Company' s OEM customers have significant investments in their existing solutions and have the substantial resources necessary to enhance existing products and to develop future products. These OEMs possess or may develop competing imaging systems technologies and may implement these systems into their products, thereby replacing the Company' s current or proposed technologies, eliminating a need for the Company' s services and products and limiting the Company' s future opportunities. Therefore, Peerless must persuade these OEMs to outsource the development of their imaging systems to the Company and to provide products and solutions to these OEMs that cost-effectively compete with their internally developed products. Peerless also competes with software and engineering services provided in the digital document product marketplace by other systems suppliers to OEMs.

As the digital document printing industry continues to develop, competition and pricing pressures will increase from OEMs, existing competitors and other companies that may enter the Company' s existing or future markets with similar or substitute solutions that may be less costly or provide better performance or functionality. Peerless anticipates increasing competition for the Company' s color products under development, particularly as new competitors develop and enter products in this marketplace. Some of the Company' s existing competitors, many of the Company' s potential competitors, and virtually all of the Company' s OEM customers have substantially greater financial, technical, marketing and sales resources than Peerless. If price competition increases, competitive pressures could require the Company to reduce the amount of royalties received on new licenses and to reduce the cost of the Company' s engineering services in order to maintain existing business and generate additional product licensing revenues. This could reduce profit margins and result in losses and a decrease in market share. No assurance can be given as to the Company' s ability to compete favorably with the internal development capabilities of the Company' s current and prospective OEM customers or with other third party digital imaging system suppliers and the inability to do so would have a material adverse effect on the Company' s operating results.

The Company' s reserves for accounts receivable may not be adequate.

The Company' s net trade accounts receivable was $2.0 million as of January 31, 2005, a decrease from $6.1 million as of January 31, 2004. Significant collections at the end of fiscal year 2005 and a $2.5 million receivable from a customer not received until February 2004 after the close of fiscal year 2004 accounted for the decrease. Although Peerless believes that the Company' s reserves for accounts receivable are adequate for the remainder of fiscal year 2006, there can be no assurance this is the case. If the Company' s reserves for accounts receivable are inadequate, it could have a material adverse effect on the Company' s results of operations.

If Peerless fails to adequately protect the Company' s intellectual property or faces a claim of intellectual property infringement by a third party, Peerless could lose the Company' s intellectual property rights or be liable for damages.

The Company' s success is heavily dependent upon the Company' s proprietary technology. To protect the Company' s proprietary rights, Peerless relies on a combination of patent, copyright, trade secret and trademark laws, as well as the early implementation and enforcement of nondisclosure and other contractual restrictions. As part of the Company' s confidentiality procedures, Peerless' policies are to enter into written nondisclosure agreements with the Company' s employees, consultants, prospective customers, OEMs and strategic partners and to take affirmative steps to limit access to and distribution of the Company' s software, intellectual property and other proprietary information.

Despite these efforts, Peerless may be unable to effectively protect the Company' s proprietary rights and the enforcement of the Company' s proprietary rights may be cost prohibitive. Unauthorized parties may attempt to copy or otherwise obtain, distribute, or use the Company' s products or technology. Monitoring unauthorized use of the Company' s products is difficult. Peerless cannot be certain that the steps it takes to prevent unauthorized use of its technology, particularly in countries where the laws may not protect proprietary rights as fully as in the United States, will be effective.

The Company' s source code also is protected as a trade secret. However, from time to time Peerless licenses the Company' s source code to OEMs, which subjects the Company to the risk of unauthorized use or misappropriation despite the contractual terms restricting disclosure, distribution, copying, and use. In addition, it may be possible for unauthorized third parties to copy the Company' s products or to reverse engineer the Company' s products in order to obtain and subsequently use and distribute the Company' s proprietary information.

The Company holds patents issued in the United States, France, Germany, Great Britain, Japan, Taiwan and Hong Kong. The issued patents relate to techniques developed by the Company for generating output for continuous synchronous raster output devices, such as laser printers, compressing data for use with output devices, filtering techniques for use with output devices and communicating with peripheral devices over a network.

The Company also has patent applications pending in the United States, the European Patent Office, Japan, Hong Kong, Taiwan, China, Australia, Korea, and India.

There can be no assurance that patents Peerless holds will not be challenged or invalidated, that patents will issue from any of the Company' s pending applications or that any claims allowed from existing or pending patents will be of sufficient scope or strength (or issue in the countries where products incorporating the Company' s technology may be sold) to provide meaningful protection or any commercial advantage to the Company. In any event, effective protection of intellectual property rights may be unavailable or limited in certain countries. The status of United States patent protection in the software industry will evolve as the United States Patent and Trademark Office grants additional patents. Patents have been granted to fundamental technologies in software after the development of an industry around such technologies and patents may be issued to third parties that relate to fundamental technologies related to the Company' s technology.

As the number of patents, copyrights, trademarks and other intellectual property rights in the Company' s industry increases, products based on the Company' s technologies may become the subjects of infringement claims. There can be no assurance that third parties will not assert infringement claims against the Company in the future. Any such claims, regardless of merit, could be time consuming, divert the efforts of the Company' s technical and management personnel from productive tasks, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to the Company, or at all, which could have a material adverse effect on the Company' s operating results. In addition, Peerless may initiate claims or litigation against third parties for infringement of the Company' s proprietary rights or to establish the validity of the Company' s proprietary rights. Litigation to determine the validity of any claims, whether or not such litigation is determined in the Company' s favor, could result in significant expenses and divert the efforts of the Company' s technical and management personnel from productive tasks. In addition, Peerless may lack sufficient resources to initiate a meritorious claim. In the event of an adverse ruling in any litigation regarding intellectual property, Peerless may be required to pay substantial damages, discontinue the use and sale of infringing products, and expend significant resources to develop non-infringing technology or obtain licenses to infringing or substituted technology. The Company' s failure to develop, or license on acceptable terms, a substitute technology, if required, could have a material adverse effect on the Company' s operating results.

The Company' s international activities may expose the Company to risks associated with international business.

Peerless is substantially dependent on the Company' s international business activities. Risks inherent in the Company' s international business activities include:

- disruptions by terrorists of normal channels of distribution;
- disruptions by terrorists of normal communications lines;
- major currency rate fluctuations;
- changes in the economic condition of foreign countries;
- the imposition of government controls;
- tailoring of products to local requirements;
- trade restrictions;
- changes in tariffs and taxes; and
- the burdens of complying with a wide variety of foreign laws and regulations, any of which could have a material adverse effect on the Company' s operating results.

If the Company is unable to adapt to international conditions, its business may be adversely affected.

Demand from Pacific Rim customers has continued to and may continue to decline.

During the past several years, and continuing into fiscal year 2006, the Pacific Rim economies have been financially depressed. As a result, companies in the imaging industry have reported negative financial impacts attributable to a decrease in demand from Pacific Rim customers. The Company' s Pacific Rim customers are comprised primarily of companies headquartered in Japan. These Japanese OEMs sell products containing the Company' s technology primarily in the North American, European, and Asian marketplaces. These revenues have declined and there can be no assurance that revenues from Japanese OEMs will not continue to decline in future quarters.

The Company' s stock price may experience extreme price and volume fluctuations.

The Company' s common stock has experienced price volatility. In the 60-day period ending April 26, 2005, the closing price of the stock ranged from $1.68 per share to $2.62 per share, and, since the beginning of fiscal year 2005, the stock has closed as low as $0.84 per share. Such price volatility may occur in the future. Factors that could affect the trading price of the Company' s common stock include:

macroeconomic conditions;

actual or anticipated fluctuations in quarterly results of operations;

announcements of new products or significant technological innovations by the Company or its competitors;

developments or disputes with respect to proprietary rights;

losses of major OEM customers;

general trends in the industry; and

overall market conditions and other factors.

In addition, the stock market historically has experienced extreme price and volume fluctuations, which have particularly affected the market price of securities of many related high technology companies and which at times have been unrelated or disproportionate to the operating performance of such companies.

The Company' s common stock was moved to the Nasdaq SmallCap Market and may not provide adequate liquidity.

On July 30, 2004, the Company announced that its common stock had been transferred from the Nasdaq National Market to the Nasdaq SmallCap Market. There can be no assurance, however, that the Company will be able to maintain compliance with the continued listing standards of the Nasdaq SmallCap Market. For example, if the minimum bid price of the Company' s common stock falls below $1.00, and remains below $1.00 for thirty consecutive business days, the Company will not be in compliance with the Nasdaq SmallCap Market minimum bid requirements under Marketplace Rule 4310(c)(4).

If Peerless is not able to maintain compliance, the Company' s common stock may be subject to removal from listing on the Nasdaq SmallCap Market. Trading in the Company' s common stock after a delisting, if any, would likely be conducted in the over-the-counter markets in the so-called "pink sheets" or the National Association of Securities Dealers' Electronic Bulletin Board and could also be subject to additional restrictions. As a consequence of a delisting, the Company' s stockholders would find it more difficult to dispose of, or to obtain accurate quotations as to the market value of, the Company' s common stock. In addition, a delisting would make the Company' s common stock substantially less attractive as collateral for margin and purpose loans, for investment by financial institutions under their internal policies or state legal investment laws or as consideration in future capital raising transactions.

The Company's business may suffer if the Company's third party distributors are unable to distribute the Company's products and address customer needs effectively.

Peerless has developed a "fabless" distribution model for the sale of ASICs. Peerless has no direct distribution experience and places reliance on third party distributors to maintain inventories to address OEM needs, manage manufacturing logistics, and distribute the product in a timely manner. There can be no assurance that these distribution agreements will be maintained or will prove adequate to meet the Company' s needs and contractual requirements.

Peerless relies on certain third party providers for applications to develop the Company's ASICs. As a result, Peerless is vulnerable to any problems experienced by these providers, which may delay product shipments to the Company's customers.

Currently, Peerless relies on two independent parties, IBM Microelectronics and NEC Microelectronics, each of which provides unique ASICs incorporating the Company' s imaging technology for use by the Company' s OEMs. These sole source providers are subject to materials shortages, excess demand, reduction in capacity and/or other factors that may disrupt the flow of goods to the Company' s customers thereby adversely affecting the Company' s customer relationships. Any such disruption could limit or delay production or shipment of the products incorporating the Company' s technology, which could have a material adverse effect on the Company' s operating results.

Peerless' licensing revenue is subject to significant fluctuations.

The Company' s recurring licensing revenue model has shifted from per-unit royalties paid upon OEM shipment of its product and guaranteed quarterly minimum royalties to a model that results in revenues associated with the sale of SDKs and block licenses. The reliance on block licenses has occurred due to aging OEM products in the marketplace, OEM demands in negotiating licensing agreements, reductions in the number of OEM products shipping and a design win mix that changed from object code licensing arrangements to SDKs. Revenues may continue to fluctuate significantly from quarter to quarter as the number and value of design wins vary, or if the signing of block licenses are delayed or the licensing opportunities are lost to competitors. Any of these factors could have a material adverse effect on the Company' s operating results.

The Company's revenue from engineering services is subject to significant fluctuations.

Peerless has experienced a significant reduction in the financial performance of its engineering services that has been caused by many factors, including:

- product development delays;
- potential non-recurring engineering reduction for product customization;
- third party delays; and
- loss of new engineering services contracts.

There can be no assurance that these and similar factors will not continue to impact future engineering services results adversely.

Peerless may be unable to deploy the Company's employees effectively in connection with changing demands from the Company's OEM customers.

The industry in which Peerless operates has experienced significant downturns, both in the United States and abroad, often in connection with, or in anticipation of, maturing product cycles and declines in general economic conditions. Over the past two years, Peerless has experienced a shift in OEM demand from the historically prevailing requirement for turnkey solutions toward SDKs. Because Peerless has experienced a general decrease in demand for engineering services, engineering services resources have been re-deployed to research and development. Should this trend abruptly change, Peerless may be unable to re-deploy labor effectively and in a timely manner, which inability could have a material adverse effect on the Company' s operational results.

Peerless may be unable to implement its business plan effectively.

The Company' s ability to implement the Company' s business plan, develop and offer products and manage expansion in rapidly developing and disparate marketplaces requires comprehensive and effective planning and management. The growth in the complexity of business relationships with current and potential customers and third parties has placed, and will continue to place, a significant strain on management systems and resources. The Company' s failure to continue to improve upon the operational, managerial and financial controls, reporting systems and procedures in its imaging business or the Company' s failure to expand and manage its workforce could have a material adverse effect on the Company' s business and financial results.

Item 2. Properties

The Company leases its principal facilities in El Segundo, California. The operating lease, as amended, expires in December 2007. The Company also leases office space in Kent, Washington for PSIP and in Japan. The lease on the Kent property expires in May 2010. The lease on the Japan property expires in October 2006. The Company believes that its existing leased space is adequate for its current operations and that suitable replacement and additional space will be available in the future on commercially reasonable terms. In March 2004, the Company terminated a lease due to expire in May 2004 for leased space in Redwood City, CA, which was in excess of the Company' s needs.

Item 3. Legal Proceedings

None.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of the Company' s stockholders during the fourth quarter of fiscal year 2005.

PART II

Item 5. Market for Registrant' s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company' s common stock was traded on the Nasdaq National Market under the symbol "PRLS" since its initial public offering on September 26, 1996 until July 30, 2004, when the Company' s common stock was moved to the Nasdaq SmallCap Market. The table below sets forth, during the periods indicated, the high and low sales price for the Company' s common stock as reported on the Nasdaq National and SmallCap Markets.

	Fiscal Year Ended January 31,			
	2005		2004	
Quarter	High	Low	High	Low
First	$ 2.65	$ 1.55	$ 2.12	$ 1.36
Second	$ 2.03	$ 0.90	$ 3.33	$ 1.43
Third	$ 1.60	$ 0.75	$ 4.00	$ 2.75
Fourth	$ 1.75	$ 1.00	$ 3.70	$ 1.91

The closing price of the Company' s common stock on April 26, 2005 was $2.61. As of April 26, 2005, there were approximately 129 holders of record of the Company' s common stock.

Dividend Policy

The Company has not declared or paid any cash dividends on its common stock during any period for which financial information is provided in this Annual Report on Form 10-K. The Company currently intends to retain future earnings, if any, to fund the development and growth of its business and does not anticipate paying any cash dividends on its common stock in the foreseeable future.

Item 6. Selected Financial Data

The statement of operations data for the fiscal years ended January 31, 2005, 2004, and 2003 and the balance sheet data at January 31, 2005 and 2004, are derived from, and should be read in conjunction with, the audited consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K. The data set forth below (in thousands, except per share data) are qualified in their entirety by, and should be read in conjunction with, "Management' s Discussion and Analysis of Financial Condition and Results of Operations" and the audited consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K.

	Years Ended January 31,				
	2005	2004	2003	2002	2001
Statement of Operations Data:					
Net sales	$ 23,078	$ 25,254	$ 31,757	$ 29,767	$ 27,407
Income (loss) from operations	(5,677)	(5,793)	240	(9,948)	(17,228)
Net income (loss)	(5,805)	(4,861)	124	(10,997)	(17,649)
Basic earnings (loss) per share	(0.37)	(0.31)	0.01	(0.73)	(1.19)
Diluted earnings (loss) per share	(0.37)	(0.31)	0.01	(0.73)	(1.19)

	Years Ended January 31,				
	2005	2004	2003	2002	2001
Balance Sheet Data:					
Total assets	$ 12,647	$ 19,307	$ 24,107	$ 24,934	$ 37,108
Long-term obligations	418	366	1,384	2,181	2,357

Selected Quarterly Financial Data (Unaudited):

Quarter	Year Ended January 31, 2005 Fourth	Third	Second	First	Year Ended January 31, 2004 Fourth	Third	Second*	First*
Revenues	$ 8,281	$ 5,001	$ 6,303	$ 3,493	$ 7,653	$ 5,762	$ 6,152	$ 5,687
Gross margin	5,710	2,881	3,920	1,754	5,751	3,004	3,126	3,037
Gross margin %	68.95%	57.61 %	62.19 %	50.21 %	75.15%	52.13 %	50.81 %	53.40 %
Income (loss) from operations	$ 1,131	$ (1,330)	$ (1,469)	$ (4,009)	$ 800	$ (2,648)	$ (2,522)	$ (1,423)
Net income (loss)	1,120	(1,346)	(1,467)	(4,112)	643	(2,527)	(2,797)	(180)
Basic earnings (loss) per share	0.07	(0.08)	(0.09)	(0.26)	0.04	(0.16)	(0.18)	(0.01)
Diluted earnings (loss) per share	0.07	(0.08)	(0.09)	(0.26)	0.04	(0.16)	(0.18)	(0.01)

* The Company has reclassified the amounts of $138 and $23 in the second and first quarter, respectively, from cost of revenues to operating expenses − research and development.

Item 7. Management' s Discussion and Analysis of Financial Condition and Results of Operations

The following analysis contains forward-looking statements that involve risks and uncertainties. The statements contained in this Annual Report on Form 10-K that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including without limitation, statements regarding the Company' s expectations, beliefs, intentions or strategies regarding the future. All forward-looking statements included in this Annual Report on Form 10-K are based on current expectations, estimates, forecasts and projections about the industry in which Peerless operates, management' s beliefs and assumptions made by management. These statements are not guarantees of future performance and involve certain known and unknown risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. For a discussion of factors and trends that could impact the Company' s business and results, please refer to the section above entitled "Certain Factors and Trends Affecting Peerless and Its Business."

The following should be read in conjunction with the audited consolidated financial statements and related notes thereto contained in this Annual Report on Form 10-K.

Highlights

Consolidated revenues for fiscal year 2005 were $23.1 million, an 8.6% decrease from the prior fiscal year. The decrease in revenues was primarily attributable to lower product licensing fees and engineering services revenues, which was partially offset by an increase in revenue from the Company' s application specific integrated circuits (ASICs). Product licensing revenues decreased as a result of decreased demand for OEM' s products containing the Company' s technologies, which resulted from the shift in demand from monochrome to color technologies and with OEMs developing their own solutions in monochrome product offerings. Engineering services revenues also decreased in fiscal year 2005 due to lack of design wins. Product licensing revenues for fiscal year 2005 were $18.2 million, including $12.8 million of block licenses, a decrease of 8.9% from the previous fiscal year. Fourteen block licensing agreements totaling $13.1 million were signed during fiscal year 2005, $12.7 million of which was recognized as revenue during fiscal year 2005. The remaining $0.4 million will be recognized in the second quarter of fiscal year 2006. The Company launched its new Everest controller product utilizing *Peerless Sierra Technologies* in the fourth quarter of fiscal year 2005 and, subsequent to January 31, 2005, the Company obtained a design win in a Memorandum of Understanding ("MOU") with Kyocera Mita Corporation that would involve the development of future products utilizing *Peerless Sierra Technologies.* The Company believes that these events will lead to validation of the Company' s color offering, which will facilitate future OEM design wins, and subsequent licensing revenues.

Engineering services and maintenance contract backlog at January 31, 2005 was approximately $0.6 million; this compares to $0.4 million as of January 31, 2004, the low level reflecting the lack of design wins in fiscal years 2005 and 2004. Subsequent to January 31, 2005, the Company entered into a binding MOU with Kyocera Mita that includes minimum payments of $8 million per year for the next three years for engineering services.

On February 20, 2003, the Company announced the sale of its remaining interest in Netreon. As a result of the sale, the Company recorded in other income a gain of $971,000, net of expenses, associated with this transaction in the first quarter of fiscal year 2004. The Company had announced the divestiture of its Netreon storage management operations on January 31, 2002, effective January 29, 2002. Peerless retained the networking technology obtained from the Company' s 1999 acquisition of Netreon for continuing integration into Peerless' core document imaging products. As a result of the divestiture, the Company experienced a decline in operating expenses of approximately 30% in fiscal year 2003 from levels experienced during fiscal year 2002. Because the effective date of the divestiture so closely approximated the Company' s year end, the fiscal year 2002 consolidated results of operations included Netreon' s results for the entire year.

While the Company continued to improve on and support its core monochrome imaging operations and technologies, it also continued to increase its focus on developing its new high performance color architecture − *Peerless Sierra Technologies.* The Company began shipping a new Everest controller for the Konica Minolta bizhubtm 350 during fiscal year 2005 to Konica Minolta dealers. As a result of this and the Kyocera Mita MOU, the Company believes that on a going forward basis revenue generated from the Company' s *Peerless Sierra Technologies* will begin to increase as a percentage of total revenue.

General

The Company generates revenue from its OEMs through the sale of imaging solutions in either turnkey or SDK form. Historically, OEM demand for turnkey solutions had exceeded demand for SDK solutions. However, in the fiscal year 2000, the Company experienced a shift in demand away from turnkey solutions towards demand for the Company' s SDKs, particularly for its mature monochrome solutions. The Company has attempted to expand its high performance color solutions, by seamlessly incorporating the Company' s networking technologies and related imaging technologies licensed from third parties.

The Company' s product licensing revenues are comprised of both recurring per unit and block licensing revenues and development licensing fees for source code or SDKs. Licensing revenues are derived from per unit fees paid periodically by the Company' s OEM customers upon manufacturing and subsequent commercial shipment of products incorporating the Company' s technology. Licensing revenues are also derived from arrangements in which the Company enables third party technology, such as solutions from Adobe or Novell, to be used with the Company and/or OEM products.

Block licenses are per-unit licenses made in large volume quantities to an OEM for products either in or about to enter into distribution into the marketplace. Payment schedules for block licenses are negotiable and payment terms are often dependent on the size of the block and other terms and conditions of the block license being acquired. Typically, payments are made in either one lump sum or over a period of four or more quarters.

Revenue received for block licenses is recognized in accordance with SOP 97-2, which requires that revenue be recognized after acceptance by the OEM and if fees are fixed and determinable and the collection of fees is probable. For block licenses that have a significant portion of the payments due within twelve months, revenue is recognized at the time the block license becomes effective.

The Company also has engineering services revenues that are derived primarily from adapting the Company' s software and supporting electronics to specific OEM requirements. The Company provides its engineering services to OEMs seeking a turnkey imaging solution for their digital document products. The Company' s maintenance revenues are derived from software maintenance agreements. Maintenance revenues currently constitute a small portion of total revenue.

As part of the total solution offered to its OEMs, the Company developed a direct distribution channel for its ASIC chips. Under this "fabless" model, Peerless supplies ASIC chips from the foundry directly to the OEMs through third party distributors, which include Arrow Electronics and Marubun Corporation. The Company is responsible for marketing and sales administration, including the billings and collections to and from its OEMs and distributors, and the third party is responsible for the coordination of production with the foundry, maintenance of necessary inventories, and providing just-in-time delivery to OEMs and distributors.

The Company derives revenues from the sale of controllers for MFP devices. Peerless sells its controllers to certain OEM dealers for distribution to end users. Because it is a relatively new product, the Company has been unable to establish a history regarding returns of the products shipped. Therefore, the Company recognizes revenue only upon sales through to end users.

Historically, a limited number of customers have provided a substantial portion of the Company' s revenues. Therefore, the availability and successful closing of new contracts, or modifications and additions to existing contracts with these customers may materially impact the Company' s financial position and results of operations from quarter to quarter.

Peerless' technology has addressed the worldwide market for monochrome printers (21-69 pages per minute, or "PPM") and MFP (21-110 PPM). This market has been consolidating, and the demand for the monochrome technology and products offered by the Company declined throughout fiscal year 2005. The Company believes that unit volume for these types of printers will grow at lower rates than in past years. Available data indicate that retail prices are declining in these segments. There has been a decline in the number of monochrome contracts that the Company has with OEMs under which the Company is currently performing services and granting licenses, and this decline is likely to continue along with the demand for the monochrome technology and products the Company presently offers. Competitors have merged into larger business units with the resulting strength to acquire and impose a competitive advantage in the Company' s market segments.

Sales decreased during fiscal year 2005, as the Company is continuing to meet sales resistance from its customers. In the past, OEMs have reduced the absolute number of new products being developed and in some instances, OEMs have preferred to perform in-house development projects for the products that they are developing and/or planning to launch. Although there have been fewer opportunities for the Company to sell its turnkey services and SDKs, the Company continued to support its current OEM controller customers in the digital printing devices business with its existing technology and has sized the organization to provide the necessary support and maintenance.

In response to the Company' s belief that the demand for the Company' s core monochrome offerings may grow at lower rates than in past years and that the Company may continue to meet sales resistance from its customers, Peerless has recently developed and commercialized high performance color imaging and printing technologies and a new open architecture named *"Peerless Sierra Technologies."* Peerless believes that products based on its *Peerless Sierra Technologies* address key growth areas in the imaging market including: increased demand for color imaging, the emergence of MFPs, and continued demand for faster low cost monochrome printing solutions, to which many of the *Peerless Sierra Technologies* attributes are applicable.

During the last fiscal year, Peerless launched a new MFP controller product, Everest, containing *Peerless Sierra Technologies* into the marketplace. Peerless believes that the launch of its high performance color MFP controller into the distribution channels will be followed by sales to OEMs for utilization of its high performance color technology, with licensing revenues beginning in fiscal year 2007. See, however, "If the Company is unable to achieve its expected level of sales of *Peerless Sierra Technologies* on a timely basis, the Company' s future revenue and operating results may be harmed" and "If the marketplace does not accept Peerless' new *Peerless Sierra Technologies*, the Company' s future revenues and operating results may be harmed" in the section entitled "Certain Factors and Trends Affecting Peerless and Its Business" of this Annual Report on Form 10-K. Peerless believes that its new *Peerless Sierra Technologies* will contribute an increasing percentage of the Company' s overall revenue in the future.

The Company has addressed the deterioration in the demand for its solutions by investing in leading edge technologies, by sizing its organization to manage the current business requirements of imaging for digital document products and has adapted its pricing model to changing market conditions. The Company has also addressed the deterioration in revenues by expanding its offerings in new geographic regions and in distribution channels.

In addition, as a result of the complexities of the imaging industry, the Company continues to explore opportunities to enhance the value of the Company, including new market opportunities, mergers, acquisitions and/or the sale of all or a portion of Company' s assets.

Critical Accounting Policies

Management' s Discussion and Analysis of Financial Condition and Results of Operations addresses the Company' s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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. On an on-going basis, management evaluates its estimates and judgments. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which 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.

Management believes the following critical accounting policies, among others, affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

The Company accounts for its software revenues in accordance with Statement of Position ("SOP") 97-2, "Software Revenue Recognition" as amended by SOP 98-9, Staff Accounting Bulletin No. 104, "Revenue Recognition" and Emerging Issues Task Force 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent." Over the past two years, the Company entered into block license agreements that represent unit licenses for products that will be licensed over a period of time. In accordance with SOP 97-2, revenue is recognized when the following attributes have been met: 1) an agreement exists between the Company and the OEM selling product utilizing the Company' s intellectual property and/or a third party' s intellectual property for which Peerless is an authorized licensor, 2) delivery and acceptance of the intellectual property has occurred, 3) the fees associated with the sale are fixed and determinable and 4) collection of the fees are probable. Under the Company' s accounting policies, fees are fixed and determinable if 90% of the fees are to be collected within a twelve-month period, in accordance with SOP 97-2. If more than 10% of the payments of fees extend beyond a twelve-month period, they are recognized as revenues when they are due for payment, in accordance with SOP 97-2. As of January 31, 2004, the Company had no such revenues to be recognized in future periods.

The Company recognizes revenues for certain of its engineering services projects on a percentage-of-completion basis, in accordance with Accounting Research Bulletin 45, "Long-Term Construction-Type Contracts" and SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." The estimates to complete the projects are determined by the individual project-engineering manager responsible for the oversight of the individual projects. The estimates are made at the end of each accounting period and are subject to unforeseen circumstances that can increase or decrease the hours necessary to complete the efforts. For fiscal year 2004, the Company reported no engineering services revenues on a percentage-of-completion basis.

The Company derives revenues from the shipments of its controllers to certain dealers of OEM MFP devices. Because the product is relatively new, Peerless has been unable to establish a history of returns of the products by the dealers. Therefore, the Company recognizes revenues for these shipments only upon the sale of the controllers through to end users.

The Company provides an accrual for estimated product licensing costs owed to third party vendors whose technology is included in the products sold by the Company. The accrual is impacted by estimates of the mix of products shipped under certain of the Company' s block license agreements. The estimates are based on historical data and available information as provided by the Company' s customers concerning projected shipments. Should actual shipments under these agreements vary from these estimates, adjustments to the estimated accruals for product licensing costs may be required. Such losses have historically been within management' s expectations.

As of January 31, 2005, the Company had net operating loss carryforwards available to reduce future federal and state income of approximately $13.7 million and $8.2 million, respectively, which begin to expire in fiscal years 2021 for federal and 2006 for state, respectively. In addition, as of January 31, 2005, the Company had tax credit carryforwards available to reduce future income tax liabilities of approximately $9.4 million, which begin to expire in fiscal year 2006. The realization of these assets is based upon management' s estimates of future taxable income. The Company has provided a valuation allowance for all of its net deferred tax assets because of the uncertainty with respect to the Company' s ability to generate future taxable income to realize the deferred tax assets. With a change in management' s assessment of the uncertainty, the valuation allowance will be adjusted accordingly.

The Company grants credit terms in the normal course of business to its customers. The Company continuously monitors collections and payments from its customers and maintains allowances for doubtful accounts for estimated losses resulting from the inability of any customers to make required payments. Estimated losses are based primarily on specifically identified customer collection issues. If the financial condition of any of the Company' s customers, or the economy as a whole, were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Actual results have historically been consistent with management' s estimates.

The Company' s recurring product licensing revenues are dependent, in part, on the timing and accuracy of product sales reports received from the Company' s OEM customers. These reports are provided only on a calendar quarter basis and, in any event, are subject to delay and potential revision by the OEM. Therefore, the Company is required to estimate all of the recurring product licensing revenues for the last month of each fiscal quarter and to further estimate all of its quarterly revenues from an OEM when the report from such OEM is not received in a timely manner. In the event the Company is unable to estimate such revenues accurately prior to reporting financial results, the Company may be required to adjust revenues in subsequent periods. Fiscal year 2005 revenues subject to such estimates were minimal. Actual results have historically been consistent with management' s estimates.

The valuation of the Company' s inventory is dependent on its ability to estimate the level of future sales of its *Peerless Sierra Technologies* based controllers. Although the Company believes that it has enough information to estimate such sales, the product' s sales history is short, and, if actual results differ materially from the estimates, the Company may be required to adjust its valuation of its inventory.

Results of Operations

The following table sets forth, for the periods indicated, the percentage relationship of certain items from the Company' s statements of operations to total revenues.

	Percentage of Total Revenues Years Ended January 31,			Percentage Change Years Ended January 31,	
	2005	2004	2003	2005 vs. 2004	2004 vs. 2003
Statements of Operations Data:					
Revenues:					
Product licensing	79 %	79 %	78 %	(9)%	(20)%
Engineering services and maintenance	11	13	16	(16)	(37)
Other	10	8	6	5	16
Total revenues	100	100	100	(9)	(20)
Cost of revenues:					
Product licensing	19	25	26	(32)	(23)
Engineering services and maintenance	14	12	9	9	8
Other	5	4	3	22	(4)
Total cost of revenues	38	41	38	(15)	(14)
Gross margin	62	59	62	(4)	(24)
Operating expenses:					
Research and development	51	47	31	−	21
Sales and marketing	16	18	14	(19)	−
General and administrative	20	17	16	3	(14)
Total operating expenses	87	82	61	(4)	7
Income (loss) from operations	(25)	(23)	1	(2)	*
Interest income, net	−	1	1	(83)	(63)
Other income	−	6	−	*	*
	−	7	1	(99)	*
Income (loss) before income taxes	(25)	(16)	2	36	(778)
Provision for income taxes	−	3	2	(78)	42
Net income (loss)	(25)%	(19)%	0 %	19 %	* %

* Percentage change calculations not meaningful.

Net Income

Net loss for the twelve month period ended January 31, 2005 was $(5.8) million or $(0.37) per basic and diluted share, compared to a net loss of $(4.9) million, or $(0.31) per basic and diluted share, in fiscal year 2004, and net income of $0.1 million, or $0.01 per basic and diluted share, in fiscal year 2003.

Revenues

Consolidated revenues for fiscal year 2005 were $23.1 million, compared to $25.3 million in fiscal year 2004, and $31.8 million in fiscal year 2003. The decreases in both periods were primarily attributable to decreased licensing and engineering services revenues, which were partially offset by higher ASICs revenues.

Product licensing revenues for fiscal year 2005 were $18.2 million, compared to $19.9 million in fiscal year 2004, and $24.9 million in fiscal year 2003. Block licensing agreements totaling $13.1 million were signed during fiscal year 2005, of which $12.7 million was recognized as revenue during the year. The remaining $0.4 million will be recognized in the second quarter of fiscal year 2006. This is compared with block licensing agreements of $9.4 million signed in fiscal year 2004, all of which was recognized as revenue during fiscal year 2004. The decreases in product licensing revenue in fiscal years 2005 and 2004 are mainly attributable to the decrease in demand for the OEMs' products containing the Company' s core monochrome technology.

Engineering services and maintenance revenues generated by the Company were $2.7 million in fiscal year 2005, compared to $3.2 million in fiscal year 2004, and $5.0 million in fiscal year 2003. The decreases were primarily the result of a lack of design wins for the Company' s *Peerless Sierra Technologies.* Revenue generated by ASIC sales was $2.3 million in fiscal year 2005, compared to $2.1 million in fiscal year 2004, and $1.9 million in fiscal year 2003. Contract and maintenance backlog at January 31, 2005 was approximately $0.6 million, as compared with $0.4 million at January 31, 2004.

Cost of Revenues

Cost of revenues for fiscal year 2005 was $8.8 million, compared to $10.3 million in fiscal year 2004, and $12.1 million in fiscal year 2003. Product licensing costs were $4.3 million in fiscal year 2005, compared to $6.3 million in fiscal year 2004, and $8.3 million in fiscal year 2003. The decreases in fiscal years 2005 and 2004 as compared to fiscal years 2004 and 2003, respectively, were due to decreased product licensing revenues and lower levels of third party technologies in those revenues than in the previous comparable years. In fiscal year 2004, the Company recorded an additional accrual for the settlement of certain third party licensing costs totaling $0.5 million.

Gross Margin

Gross margin as a percentage of total revenues was 62% in fiscal year 2005, compared to 59% in fiscal year 2004, and 62% in fiscal year 2003. The increase in fiscal year 2005 was due primarily to a proportionately higher level of Peerless intellectual property in its licensing revenues, resulting in a lower cost of sales. The decrease in fiscal year 2004 was largely due to higher levels of product licensing costs for third party technology associated with certain of the Company' s licensing revenues.

Operating Expenses

Operating expenses for fiscal year 2005 were $19.9 million, compared to $20.7 million in fiscal year 2004, and $19.4 million in fiscal year 2003.

Research and development expenses were $11.7 million in fiscal year 2005, compared to $11.8 million in fiscal year 2004, and $9.8 million in fiscal year 2003. In fiscal year 2005, expenditures increased early in the fiscal year, as development of the Company' s *Peerless Sierra Technologies* continued. However, as the development effort neared its completion, research and development expenditures decreased in the ensuing quarters as compared to the comparable prior year' s quarters, resulting in a small decrease from fiscal year 2004. The increase in fiscal year 2004 was primarily due to higher staffing and consulting costs associated with the development of the Company' s *Peerless Sierra Technologies*.

Sales and marketing expenses were $3.7 million in fiscal year 2005, compared to $4.5 million in fiscal year 2004, and $4.6 million in fiscal year 2003. The decrease in fiscal year 2005 from fiscal year 2004 was the result of a reduction in staffing levels. The Company continued to focus on the launch of *Peerless Sierra Technologies* and on developing new OEM customers, attending industry trade shows, and evaluating other opportunities to promote the Company' s core and new color imaging and network solutions.

General and administrative expenses were $4.6 million in fiscal year 2005, compared to $4.4 million in fiscal year 2004, and $5.1 million in fiscal year 2003. The increase in fiscal year 2005 was due primarily to increased consulting costs. The decrease in fiscal year 2004 was primarily due to the reduction of consulting costs. In addition, during fiscal year 2004, the Company received a $0.2 million insurance refund for costs associated with completed legal proceedings.

Interest Income, Other Income and Expenses, and Taxes

Interest income earned in all fiscal years was attributable to interest and investment income earned on cash and cash equivalents and investment balances. The decrease in fiscal year 2005 was primarily a result of a lower level of investments than in the previous fiscal year. The decrease in fiscal year 2004 in interest income was due to lower yields on a lower level of the Company' s investments in government and corporate bonds.

Included in other income in fiscal year 2004 was $1.0 million from the Company' s sale of its remaining interest in Netreon, Inc., announced on February 20, 2003. In addition, the Company recorded a gain of $0.6 million associated with the termination of a sublease of a portion of its leased office space at its headquarters in El Segundo, California. Additionally, the Company recorded a $121,000 loss for a correction to fiscal year 2002 reported accrued interest.

The provisions for income taxes for all fiscal years were primarily the result of foreign income taxes paid. These income taxes were paid through withholdings on payments of licensing revenues made by the Company' s customers to Peerless. In July 2004, a new tax treaty between the United States and Japan ended the requirement for such income taxes. The effect was to nearly eliminate the Company' s foreign income tax provision in all periods subsequent to the effective date of the new treaty. In fiscal year 2004, the foreign income taxes paid were offset by the release of certain long-term tax liabilities. In fiscal year 2003, the foreign income taxes paid were offset by the Company' s receipt of a tax benefit of $0.6 million as a result of a change in the tax code that allowed the Company to carry back losses to obtain a tax refund. The Company has provided a valuation allowance on its net deferred tax assets because of the uncertainty with respect to the Company' s ability to generate future taxable income to realize the deferred tax assets.

Contractual Obligations

The following table summarizes the Company' s significant contractual obligations at January 31, 2005, and the effect such obligations are expected to have on the Company' s liquidity and cash flows in future periods. This table excludes amounts already recorded on the Company' s consolidated balance sheets at January 31, 2005.

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(In thousands)		
Operating lease obligations	$ 4,276	$ 1,243	$ 2,706	$ 278	$ 49
Outstanding purchase orders	155	155	–	–	–
Total	$ 4,431	$ 1,398	$ 2,706	$ 278	$ 49

Liquidity and Capital Resources

The Company' s principal source of liquidity is its cash and cash equivalents and investments, which, as of January 31, 2005 were $6.5 million in the aggregate, compared to $9.4 million at January 31, 2004. The decrease was primarily the result of the net loss incurred during the year and the investment in inventory for the new *Peerless Sierra Technologies* controllers, net of the timing of collections of accounts receivable.

Compared to January 31, 2004, total assets at January 31, 2005 decreased 34% to $12.6 million and stockholders' equity decreased 45% to $6.5 million. The ratio of current assets to current liabilities was 1.8:1 compared to 2.3:1 last year. The Company used $2.7 million in cash during the twelve month period ended January 31, 2005 from operations as compared to $9.7 million in cash used by operations during the twelve month period ended January 31, 2004.

The Company' s investing activities during the fiscal year ended January 31, 2005 provided cash of $2.4 million. This is the result of the sales of investments to provide funds for the Company' s operations. It is the Company' s policy to invest the majority of its unused cash in low risk government and commercial debt securities. The Company has not historically purchased derivative instruments or entered into hedging transactions. For the twelve month period ended January 31, 2005, the Company invested approximately $0.2 million in property, equipment and leasehold improvements compared to $0.4 million during the previous twelve month period.

During fiscal year 2005, $0.4 million was provided by the issuance of common stock under the Company' s employee stock purchase plan and exercise of stock options. Net cash provided by financing activities was $0.3 million during fiscal year 2005 and $0.4 million in fiscal year 2004.

At January 31, 2005, net trade receivables were $4.1 million lower than at January 31, 2004, due primarily to the timing of the signings and collections of new licensing agreements at the end of the fiscal years. In fiscal year 2005, the Company signed and collected significant agreements at the end of the year; in fiscal year 2004, the Company was unable to collect agreements signed at the end of the year.

As previously mentioned, subsequent to January 31, 2005, the Company signed an MOU with Kyocera Mita Corporation. The MOU provides, among other things, for quarterly payments of $2.0 million for the next three years for the development of future products.

During fiscal year 2005, the Company established a credit facility with its bank that allows for borrowing against outstanding receivables. The credit facility generally only provides coverage for short-term working capital needs and the Company may require additional long-term capital to finance working capital requirements.

The Company expects cash and investments will increase during fiscal year 2006. The Company expects the recently signed contract with Kyocera Mita to provide much of the increase, and, although the Company expects the cash position to further increase with the expected sales growth associated with the *Peerless Sierra Technologies*, there can be no assurances that the Company will experience the anticipated increase in the *Peerless Sierra Technologies* sales subsequent to January 31, 2006. The Company expects to reduce operating expenses as a result of completion of the majority of the *Peerless Sierra Technologies* development effort. However, if the level of *Peerless Sierra Technologies* sales is lower than anticipated, the Company may need to take significant measures to preserve and maintain continued business operations. In such event, the Company may need to further reduce costs and may have to access the capital markets to raise additional funding. There is no assurance that the Company would be successful in raising capital at attractive terms or at all, and should the Company be successful in raising capital, the financing may be dilutive to current shareholders.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

As of January 31, 2005, the Company does not hold any positions in equity securities of other publicly traded companies.

The Company' s exposure to interest rate risk relates primarily to the Company' s non-equity investment portfolio. The primary objectives of the Company' s investment activities are to preserve the principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, the Company from time to time maintains a portfolio of cash equivalents, fixed rate debt instruments of the federal, state, and local governments and high-quality corporate issuers and short-term investments in money market funds. As discussed in Note 3 of the Notes to Consolidated Financial Statements in this Annual Report on Form 10-K, as of January 31, 2005, the Company held approximately $1.4 million in corporate debt securities. Although the Company is subject to interest rate risks in these investments, the Company believes an effective increase or decrease of 10% in interest rate percentages would not have a material adverse effect on its results from operations. Consequently, the Company' s interest rate risk is minimal.

The Company has not entered into any derivative financial instruments. Currently all of the Company' s contracts, including those involving foreign entities, are denominated in U.S. dollars and as a result, the

Company has experienced no significant foreign exchange gains and losses to date. The Company has not engaged in foreign currency hedging activities to date, and has no intention of doing so.

Item 8. Consolidated Financial Statements and Supplementary Data

See Index to Financial Statements on page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures.

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC' s rules and forms, and that such information is accumulated and communicated to Peerless management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13(a)-15(b) under the Securities Exchange Act of 1934, the Company carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures. Based on the foregoing, the Chief Executive Officer and Chief Financial Officer concluded that, as of end of the period covered by this report, the Company' s disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in the Company' s internal controls over financial reporting during the Company' s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company' s internal controls over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers

The information required by this Item is incorporated by reference to the Peerless Proxy Statement.

Item 11. Executive Compensation

The information required by this Item is incorporated by reference to the Peerless Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated by reference to the Peerless Proxy Statement.

Item 13. Certain Relationships and Related Transactions

The information required by this Item is incorporated by reference to the Peerless Proxy Statement.

Item 14. Principal Accounting Fees and Services

The information required by this Item is incorporated by reference to the Peerless Proxy Statement.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) *Documents filed as a part of this Annual Report on Form 10-K:*

(1) *Financial Statements:*

(2) *Financial Statement Schedule:*

The following financial statement schedule of the Company is filed as part of this Report and should be read in conjunction with the Financial Statements of the Company.

Schedules not listed above have been omitted because they are not applicable or are not required or the information required to be set forth therein is included in the Financial Statements or Notes thereto.

(b) *Exhibits:*

The following exhibits are filed as part of, or incorporated by reference into, this Annual Report on Form 10-K:

Exhibit Number	
3 .1(1)	Certificate of Incorporation of the Company.
3 .2(9)	Amended and Restated Bylaws of the Company.
4 .1	Instruments defining the rights of security holders. Reference is made to Exhibits 3.1 and 3.2.
4 .2(4)	Rights Agreement, dated October 7, 1998, between the Company and Wells Fargo Shareowner Services, a division of Wells Fargo Bank Minnesota, N.A., formerly known as Norwest Shareowner Services, as Rights Agent.
10.1(10)(2)	1996 Equity Incentive Plan, as amended and form of stock option agreements thereunder.
10.2(11)(2)	1996 Employee Stock Purchase Plan, as amended.
10.3(1)(3)	Reference Post Appendix No. 2 to the Adobe Third Party License dated February 11, 1993.
10.4(1)	Amendment No. 1 to the Adobe Third Party License dated November 29, 1993.
10.5(1)(3)	PCL Development and License Agreement (the "PCL License") dated June 14, 1993, between the Registrant and Adobe.
10.6(1)(3)	Amendment No. 1 to the PCL License dated October 31, 1993.
10.7(1)(3)	Letter Modification to the PCL License dated August 5, 1994.
10.8(1)(3)	Addendum No. 1 to the PCL License dated March 31, 1995.

10.9(1)(3)	Letter Modification to the PCL License dated August 30, 1995.
10.10(1)	Lease Agreement between the Company and Continental Development Corporation dated February 6, 1992, and Addendum, dated February 6, 1992.

Exhibit Number	
10.11(1)	First Amendment to Office Lease dated December 1, 1995, between the Company and Continental Development Corporation.
10.12(5)	Second Amendment to Office Lease dated April 8, 1997, between the Company and Continental Development Corporation.
10.13(5)	Third Amendment to Office Lease dated December 16, 1997, between the Company and Continental Development Corporation.
10.14(6)	Fourth Amendment to Office Lease dated April 22, 1998, between the Company and Continental Development Corporation.
10.15(7)	Agreement and Plan of reorganization and Merger by and among Peerless Systems Corporation, Auco Merger and Auco, Inc. dated as of April 6, 1999.
10.16(8)	Marubun Supplier/Distribution Agreement dated December 14, 1999.
10.17(8)	Lease PSN McKelvy Family Trust (386 Main Street) Standard Industrial/Commercial Single-Tenant dated March 14, 1997.
10.18(8)	Lease PSIP Kent Centennial Limited Partnership dated January 31, 1996.
10.19(2)(12)	Form of Indemnification Agreement, effective as of March 12, 2001.
10.20(13)	Settlement Agreement and Mutual Release dated April 11, 2001 between Peerless Systems Corporation and Gordon L. Hanson.
10.21(9)	Settlement Agreement and Mutual Release, effective as of April 27, 2001, by and among the State of Wisconsin Investment Board, Peerless Systems Corporation and Edward A. Gavaldon.
10.22(14)	Series A Preferred Stock Purchase Agreement dated January 29, 2002 by and among Netreon, Inc., a Delaware corporation, Netreon, Inc., a California corporation and each of the several purchasers named therein.
10.23(14)	Series A Preferred Stock Contribution Agreement dated January 29, 2002 by and between Netreon, Inc., a Delaware corporation and Peerless Systems Corporation.
10.24(3)(15)	Postscript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and the Company effective as of July 23, 1999.
10.25(3)(15)	Custom Sales Agreement between the Company and International Business Machines effective as of April 23, 2001.
10.26(3)(15)	Master Technology License Agreement dated January 16, 2000 between Konica Corporation and Peerless Systems Corporation.
10.27(3)(15)	License Software Addendum #1 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 16, 2000.
10.28(3)(15)	License Software Addendum #2 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 19, 2000.
10.29(3)(15)	License Software Addendum #3 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of July 21, 2000.
10.30(3)(15)	License Software Addendum #4 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of March 1, 2001.

10.31(3)(15)	License Software Addendum #5 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of July 1, 2001.
10.32(3)(15)	License Software Addendum #7 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 1, 2002.
10.33(3)(15)	License Software Addendum #8 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 1, 2002.
10.34(3)(15)	License Software Addendum #9 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 1, 2002.
10.35(15)	Master Technology License Agreement dated April 1, 1997 between Kyocera Corporation and Peerless Systems Corporation.

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Exhibit Number	
10.36(3)(15)	Licensed Software Addendum #1 to Master Technology License Agreement by and between Kyocera Corporation and the Company effective as of December 28, 1999.
10.37(3)(15)	Amendment #3 to Licensed Software Addendum #1 to Master Technology License Agreement by and between Kyocera Corporation and the Company effective as of September 28, 2001.
10.38(3)(15)	Licensed Software Addendum #3 to Master Technology License Agreement by and between Kyocera Mita Corporation and the Company effective as of May 1, 2002.
10.39(3)(15)	Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc.
10.40(3)(15)	Licensed System Addendum No. 1 to Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc.
10.41(3)(15)	Licensed System Addendum No. 2 to Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc.
10.42(3)(15)	Licensed System Addendum No. 3 to Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc. effective as of August 25, 2000.
10.43(3)(15)	Attachment #1 to Licensed System Addendum #3 by and between Oki Data Corporation and Peerless Systems Imaging Products, Inc. dated March 1, 2001.
10.44(3)(15)	Attachment #2 to Licensed System Addendum #3 by and between Oki Data Corporation and Peerless Systems Imaging Products, Inc. dated July 1, 2001.
10.45(3)(15)	Licensed System Addendum No. 4 to Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc. effective as of February 1, 2002.
10.46(15)	Master Technology License Agreement dated April 1, 2000 between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc.
10.47(3)(15)	Licensed System Addendum #1 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. dated April 1, 2000.
10.48(3)(15)	Licensed System Addendum #2 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc.
10.49(3)(15)	Licensed System Addendum #3 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc.
10.50(3)(15)	Attachment #1 to Licensed System Addendum #3 by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. dated May 1, 2001.
10.51(3)(15)	Attachment #2 to Licensed System Addendum #3 by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. dated July 23, 2001.
10.52(3)(15)	Licensed System Addendum #4 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. effective as of October 19, 2001.
10.53(3)(15)	Licensed System Addendum #5 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. effective as of December 1, 2001.
10.54(3)(15)	Licensed System Addendum #6 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. effective as of April 30, 2002.

10.55(3)(15)	Nest Office SDK Development and Reseller Agreement Statement of Work 8 to BDA No. N-A-1 between and Novell, Inc. and Peerless Systems Networking effective as of August 17, 1999.

Exhibit Number	
10.56(3)(15)	Amendment No. 1 to Nest Office SDK Development and Reseller Agreement Statement of Work 8 to BDA No. N-A-1 between and Novell, Inc. and Peerless Systems Networking effective as of August 17, 1999.
10.57(15)	Business Development Agreement by and between Novell and Auco, Inc effective as of September 6, 1996.
10.58(16)	Amendment No. 4 to Licensed System Addendum No. 4 dated February 1, 2002 by and between Oki Data Corporation and Peerless Systems Imaging Products, Inc. dated September 1, 2002.(15)
10.59(16)	Amendment No. 3 to Postscript Software Development Agreement by and between Adobe Systems Incorporated and the Company dated October 25, 2002.
10.60(3)(17)	Amendment No. 1 to Licensed System Agreement No. 7 dated November 1, 2001 by and between Konica Corporation and Peerless Systems Corporation dated January 1, 2003.
10.61(3)(17)	Licensed System Agreement Addendum No. 10 to Master Technology License Agreement dated January 16, 2000 by and between Konica Corporation and Peerless Systems Corporation dated January 17, 2003.
10.62(3)(17)	Licensed System Addendum #8 to Master Technology License Agreement dated April 1, 2000 by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. effective as of January 6, 2003.
10.63(3)(18)	Amendment No. 4 to the Postscript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of July 31, 2003.
10.64(3)(18)	Amendment No. 10 to the Postscript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of July 31, 2003.
10.65(3)(19)	Amendment No. 5 to Licensed System Addendum No. 4 between Oki Data Corporation and Peerless Systems Imaging Products, Inc. dated February 1, 2002.
10.66(3)(19)	Amendment No. 8 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of September 30, 2003.
10.67(3)(19)	Amendment No. 9 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of September 15, 2003.
10.68(3)(19)	Amendment No. 12 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of September 22, 2003.
10.69(20)	Licensed Software Addendum No. 14 to Master Technology License Agreements dated January 16, 2000 and June 12, 1997 by and between KonicaMinolta Business Technologies, Inc. and Peerless Systems Corporation, effective as of October 31, 2003
10.70(20)	Amendment #2 to the LSA #9 by and between KonicaMinolta Business Technologies, Inc. and Peerless Systems Corporation, effective as of November 1, 2003
10.71(20)	Amendment No. 5 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of December 16, 2003.
10.72(20)	Amendment No. 6 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of July 31, 2002.
10.73(20)	Amendment No. 7 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of May 22, 2003.

Exhibit Number	
10.74(20)	Amendment No. 11 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of February 9, 2004.
10.75(20)	Amendment No. 14 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of December 16, 2003.
10.76(20)	Amendment No. 15 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of January 6, 2004.
10.77(2)(20)	Change in Control Agreement of Chief Executive Officer.
10.78(2)(20)	Form of Change in Control Agreement of certain members of senior management.
10.79(2)(20)	Form of Transaction Incentive Plan of certain members of senior management.
10.80(21)	Amendment No. 16 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of January 6, 2004.
10.81(21)	Licensed Software Addendum #5 to Master Technology License Agreement dated April 1, 1997, entered into as of February 17, 2004.
10.82(21)	Amendment No. 19 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of April 1, 2004.
10.83(22)	Amendment to Lease between BIT Holdings Forty-Eight, Inc. and Peerless Systems Imaging Products, Inc. as of October 1, 2004.
10.84(22)	Amendment No. 17 to the Postscript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, Effective as of 15 October, 2004.
10.85(22)	Silicon Valley Bank Loan and Security Agreement between Silicon Valley Bank and Peerless Systems Corporation dated October 27, 2004.
10.86(23)	Memorandum of Understanding by and between Kyocera Mita Corporation and Peerless Systems Corporation, effective as of February 1, 2005.
10.87(23)	Amendment No. 21 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of January 1, 2005.
10.88	Confidential Separation Agreement and Mutual Release by and between Denis Retoske and Peerless Systems Corporation dated June 4, 2004.
10.89	Peerless/Consultant Consulting Agreement by and between Denis Retoske and Peerless Systems Corporation dated June 4, 2004.
10.90	Notice of Termination of Consulting Relationship Letter from Peerless Systems Corporation to Denis Retoske dated March 28, 2005.
21	Registrant' s Wholly-Owned Subsidiaries.
23.1	Consent of Independent Registered Public Accounting Firm.
24.1	Power of Attorney. Reference is made to the signature page to this Annual Report on Form 10-K.
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Previously filed in the Company' s Registration Statement on Form S-1 (File No. 333-09357), as amended and incorporated herein by reference.

(2) Management contract or compensatory plan or arrangement.

(3) Subject to a Confidential Treatment Order.

(4) Previously filed in the Company' s Current Report on Form 8-K, filed October 13, 1999, and incorporated herein by reference.

(5) Previously filed in the Company' s 1998 Annual Report filed on Form 10-K, filed April 24, 1998, and incorporated herein by reference.

(6) Previously filed in the Company' s 1999 Annual Report filed on Form 10-K, filed April 26, 1999, and incorporated herein by reference.

(7) Previously filed in the Company' s Registration Statement on Form S-4 (File No. 333-77049) as amended and incorporated herein by reference.

(8) Previously filed in the Company' s 2000 Annual Report filed on Form 10-K, filed April 28, 2000, and incorporated herein by reference.

(9) Previously filed in the Company' s Current Report on Form 8-K, filed July 2, 2001, and incorporated herein by reference.

(10) Previously filed in the Company' s Registration Statement on Form S-8 (File No. 333-73562), filed November 16, 2001, and incorporated herein by reference.

(11) Previously filed in the Company' s Registration Statement on Form S-8 (File No. 333-57362), filed March 21, 2001, and incorporated herein by reference.

(12) Previously filed in the Company' s Amendment No. 4 to its Registration Statement on Form S-3 (File No. 333-60284), filed July 27, 2001, and incorporated herein by reference.

(13) Previously filed in the Company' s 2001 Annual Report filed on Form 10-K, filed May 1, 2001, and incorporated herein by reference.

(14) Previously filed in the Company' s 2002 Annual Report on Form 10-K, filed May 1, 2002, and incorporated herein by reference.

(15) Previously filed in the Company' s Quarterly Report for the period ended July 31, 2002, filed September 16, 2002, and incorporated herein by reference.

(16) Previously filed in the Company' s Quarterly Report for the period ended October 31, 2002, filed December 16, 2002, and incorporated herein by reference.

(17) Previously filed in the Company' s 2003 Annual Report on Form 10-K filed May 1, 2003, and incorporated herein by reference.

(18) Previously filed in the Company' s Quarterly Report for the period ended July 31, 2003, filed September 15, 2003, and incorporated herein by reference.

(19) Previously filed in the Company' s Quarterly Report for the period ended October 31, 2003, filed December 15, 2003, and incorporated herein by reference.

(20) Previously filed in the Company' s 2004 Annual Report on Form 10-K filed April 30, 2004, and incorporated herein by reference.

(21) Previously filed in the Company' s Quarterly Report for the period ended April 30, 2004, filed June 14, 2004, and incorporated herein by reference.

(22) Previously filed in the Company' s Quarterly Report for the period ended October 31, 2004, filed December 15, 2004, and incorporated herein by reference.

(23) Confidential treatment has been requested with respect to the omitted portions of this Exhibit, which portions have been filed separately with the Securities and Exchange Commission.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 2nd day of May, 2005.

Peerless Systems Corporation

By: /s/ William R. Neil

William R. Neil
Vice President of Finance and
Chief Financial Officer

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Howard J. Nellor and William R. Neil, his/her attorneys-in-fact, each with the power of substitution, for him/her in any and all capacities, to sign any amendments to this Annual Report on Form 10-K, and to file the same, with Exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title	Date
/s/ Howard J. Nellor Howard J. Nellor	Chief Executive Officer, President & Director (Principal Executive Officer)	May 2, 2005
/s/ Robert G. Barrett Robert G. Barrett	Director	May 2, 2005
/s/ Louis C. Cole Louis C. Cole	Director	May 2, 2005
/s/ Thomas G. Rotherham Thomas G. Rotherham	Director	May 2, 2005
/s/ William R. Neil William R. Neil	Vice President of Finance and Chief Financial Officer (Principal Financial and Accounting Officer)	May 2, 2005

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PEERLESS SYSTEMS CORPORATION

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Peerless Systems Corporation

We have audited the accompanying consolidated balance sheets of Peerless Systems Corporation as of January 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended January 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15 (a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits 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. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit also 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Peerless Systems Corporation at January 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended January 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Los Angeles, California
March 17, 2005

PEERLESS SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended January 31,		
	2005	2004	2003
	(In thousands, except per share amounts)		
Revenues:			
Product licensing	$ 18,163	$ 19,931	$ 24,856
Engineering services and maintenance	2,664	3,178	5,047
Other	2,251	2,145	1,854
Total revenues	23,078	25,254	31,757
Cost of revenues:			
Product licensing	4,318	6,333	8,251
Engineering services and maintenance	3,353	3,066	2,850
Other	1,142	937	971
Total cost of revenues	8,813	10,336	12,072
Gross margin	14,265	14,918	19,685
Operating expenses:			
Research and development	11,723	11,771	9,766
Sales and marketing	3,668	4,540	4,552
General and administrative	4,551	4,400	5,127
Total operating expenses	19,942	20,711	19,445
Income (loss) from operations	(5,677)	(5,793)	240
Interest income, net	23	138	374
Other income	–	1,490	–
Total other income	23	1,628	374
Income (loss) before provision for income taxes	(5,654)	(4,165)	614
Provision for income taxes	151	696	490
Net income (loss)	$ (5,805)	$ (4,861)	$ 124
Basic earnings (loss) per share	$ (0.37)	$ (0.31)	$ 0.01
Diluted earnings (loss) per share	$ (0.37)	$ (0.31)	$ 0.01
Weighted average common shares outstanding – basic	15,891	15,575	15,282
Weighted average common shares outstanding – diluted	15,891	15,575	15,722

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

PEERLESS SYSTEMS CORPORATION

CONSOLIDATED BALANCE SHEETS

	January 31, 2005	January 31, 2004
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,099	$ 5,069
Short-term investments	1,397	4,341
Trade accounts receivable, less allowance for doubtful accounts of $125 and $141 in 2005 and 2004, respectively	2,037	6,146
Unbilled receivables	952	–
Inventory	688	2
Prepaid expenses and other current assets	397	620
Total current assets	10,570	16,178
Property and equipment, net	1,382	1,981
Other assets	695	1,148
Total assets	$ 12,647	$ 19,307
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 870	$ 897
Accrued wages	410	384
Accrued compensated absences	754	805
Accrued product licensing costs	2,364	2,834
Income taxes payable	8	469
Other current liabilities	462	428
Deferred revenue	897	1,323
Total current liabilities	5,765	7,140
Other liabilities	418	366
Total liabilities	6,183	7,506
Commitments		
Stockholders' equity:		
Common stock, $.001 par value, 30,000 shares authorized, 16,172 and 15,866 shares issued and outstanding in 2005 and 2004, respectively	16	15
Additional paid-in capital	49,761	49,295
Accumulated deficit	(43,239)	(37,434)
Accumulated other comprehensive income	39	38
Treasury stock, 150 shares in 2005 and 2004	(113)	(113)
Total stockholders' equity	6,464	11,801
Total liabilities and stockholders' equity	$ 12,647	$ 19,307

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

PEERLESS SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
	(In thousands)							
Balances, January 31, 2002	15,377	$ 15	150	$ (113)	$ 48,789	$ (32,697)	$ –	$ 15,994
Issuance of common stock	–	–	–	–	30	–	–	30
Exercise of stock options	73	–	–	–	63	–	–	63
Net income	–	–	–	–	–	124	–	124
Balances, January 31, 2003	15,450	15	150	(113)	48,882	(32,573)	–	16,211
Issuance of common stock	294	–	–	–	317	–	–	317
Exercise of stock options	122	–	–	–	96	–	–	96
Comprehensive loss:								
Net loss	–	–	–	–	–	(4,861)	–	(4,861)
Foreign currency translation adjustment	–	–	–	–	–	–	38	38
Total comprehensive loss								(4,823)
Balances, January 31, 2004	15,866	15	150	(113)	49,295	(37,434)	38	11,801
Issuance of common stock	251	1	–	–	337	–	–	338
Exercise of stock options	55	–	–	–	39	–	–	39
Non-employee stock option grants and modifications	–	–	–	–	66	–	–	66
Issuance of common stock warrants	–	–	–	–	24	–	–	24
Comprehensive loss:								
Net loss	–	–	–	–	–	(5,805)	–	(5,805)
Foreign currency translation adjustment	–	–	–	–	–	–	1	1
Total comprehensive loss								(5,804)
Balances, January 31, 2005	16,172	$ 16	150	$ (113)	$ 49,761	$ (43,239)	$ 39	$ 6,464

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

PEERLESS SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended January 31,		
	2005	2004	2003
		(In thousands)	
Cash flows from operating activities:			
Net income (loss)	$ (5,805)	$ (4,861)	$ 124
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities			
Depreciation and amortization	1,567	1,375	1,510
Net gain from sublease termination	–	(938)	–
Gain from Netreon sale	–	(971)	–
Loss from lease amendment	–	–	725
Other	67	(54)	31
Changes in operating assets and liabilities:			
Trade accounts receivable	4,109	(4,043)	3,215
Unbilled receivables	(952)	–	–
Inventory	(686)	–	–
Prepaid expenses and other assets	268	245	(885)
Accounts payable	(27)	209	(54)
Accrued product licensing costs	(470)	613	1,337
Deferred revenue	(426)	242	(746)
Other liabilities	(376)	(1,479)	(1,581)
Net cash provided (used) by operating activities	(2,731)	(9,662)	3,676
Cash flows from investing activities:			
Purchases of property and equipment	(230)	(388)	(215)
Purchases of available-for-sale securities	(400)	(16,819)	(2,488)
Proceeds from sales of available-for-sale securities	3,344	16,162	2,407
Purchases of software licenses	(285)	(602)	(128)
Proceeds from sale of Netreon	–	971	–
Proceeds from sublease termination	–	639	–
Restricted cash	–	–	(20)
Net cash provided (used) by investing activities	2,429	(37)	(444)
Cash flows from financing activities:			
Proceeds from issuance of common stock	338	317	30
Proceeds from exercise of common stock options	39	96	63
Payments for deferred costs for financing arrangement	(45)	–	–
Net cash provided by financing activities	332	413	93
Net increase (decrease) in cash and cash equivalents	30	(9,286)	3,325
Cash and cash equivalents, beginning of period	5,069	14,355	11,030
Cash and cash equivalents, end of period	$ 5,099	$ 5,069	$ 14,355
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Income taxes	$ 613	$ 1,325	$ 1,805
Interest	$ –	$ –	$ –

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

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share amounts)

1. Organization, Business and Summary of Significant Accounting Policies:

Organization and Business: Peerless Systems Corporation (“Peerless” or the “Company”) was incorporated in the state of California in April 1982 and reincorporated in the state of Delaware in September 1996. Peerless develops and licenses software-based digital imaging and networking systems and supporting electronic technologies and provides custom engineering services to Original Equipment Manufacturers (“OEMs”) of digital document products located primarily in the United States and Japan. Digital document products include printers, copiers, fax machines, scanners and color products, as well as multifunction products (“MFP”) that perform a combination of these imaging functions. In order to process digital text and graphics, digital document products rely on a core set of imaging software and supporting electronics, collectively known as a digital imaging system. Network interfaces supply the core technologies to digital document products that enable them to communicate over local area networks and the Internet.

Liquidity: The Company has incurred losses from operations and has reported negative operating cash flows. As of January 31, 2005, the Company had an accumulated deficit of $43.2 million and cash and short-term investments of $6.5 million. The Company has no material financial commitments other than those under operating lease agreements. The Company believes that its existing cash and short-term investments, and any cash generated from operations will be sufficient to fund its working capital requirements, capital expenditures and other obligations through the next 12 months.

The Company signed a three-year, $24.0 million agreement with Kyocera Mita Corporation subsequent to January 31, 2005 (see Note 19), which provides for quarterly payments of $2.0 million. The long term liquidity of the Company is dependent upon this agreement. Should the agreement be terminated, the Company’ s cash flow assumptions would be materially affected, and the Company would need to scale its operations to match the decrease in cash flows and may need to raise additional capital. The Company also has established a credit facility with its bank, Silicon Valley Bank, which allows for short-term borrowing against outstanding receivables from certain of the Company’ s customers. The credit facility will only provide coverage for short-term working capital needs and the Company may require additional long-term capital to finance working capital requirements.

Long term, the Company may face significant risks associated with the successful execution of its business strategy and may need to raise additional capital in order to fund more rapid expansion, to expand its marketing activities, to develop new or enhance existing services or products, and to respond to competitive pressures or to acquire complementary services, businesses, or technologies. If the Company is not successful in generating sufficient cash flow from operations, it may need to raise additional capital through public or private financing, strategic relationships, or other arrangements.

Principles of Consolidation and Basis of Presentation: The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. As a result of the Netreon exchange transaction, the Company’ s Netreon subsidiary was deconsolidated effective January 29, 2002. Although the Company initially retained an equity interest in the business formed as a result of the transaction, the Company did not record a related investment and had no continuing obligation to fund this business. In February 2003, the Company sold its remaining interest in Netreon (see Note 2).

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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 periods. Actual results could differ from those estimates.

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

The Company provides an accrual for estimated product licensing costs owed to third party vendors whose technology is included in the products sold by the Company. The accrual is impacted by estimates of the mix of products shipped under certain of the Company’ s block license agreements. The estimates are based on historical data and available information as provided by the Company’ s customers concerning projected shipments. Should actual shipments under these agreements vary from these estimates, adjustments to the estimated accruals for product licensing costs may be required.

The Company grants credit terms in the normal course of business to its customers. The Company continuously monitors collections and payments from its customers and maintains allowances for doubtful accounts for estimated losses resulting from the inability of any customers to make required payments. Estimated losses are based primarily on specifically identified customer collection issues. If the financial condition of any of the Company’ s customers, or the economy as a whole, were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Actual results have historically been consistent with management’ s estimates.

The Company’ s recurring product licensing revenues are dependent, in part, on the timing and accuracy of product sales reports received from the Company’ s OEM customers. These reports are provided only on a calendar quarter basis and, in any event, are subject to delay and potential revision by the OEM. Therefore, the Company is required to estimate all of the recurring product licensing revenues for the last month of each fiscal quarter and to further estimate all of its quarterly revenues from an OEM when the report from such OEM is not received in a timely manner. In the event the Company is unable to estimate such revenues accurately prior to reporting financial results, the Company may be required to adjust revenues in subsequent periods. Fiscal year 2005 revenues subject to such estimates were minimal.

The valuation of the Company’ s inventory is dependent on its ability to estimate the level of future sales of its *Peerless Sierra Technologies* based controllers. Although the Company believes that it has enough information to estimate such sales, the product’ s sales history is short, and, if actual results differ from the estimates, the Company may be required to adjust its valuation of its inventory.

Cash and Cash Equivalents: Cash and cash equivalents represent cash and highly liquid investments which mature within three months from date of purchase.

Investments: The Company’ s investments at January 31, 2005 and 2004 consisted of available-for-sale U.S. government debt, state and local government debt and corporate debt. Available-for-sale securities are carried at fair value. Unrealized gains and losses, if material, are reported as a separate component of stockholders’ equity. Realized gains and losses and declines in value judged to be other than temporary are included in results of operations. Realized gains and losses are calculated using the specific identification method and were not material to the Company’ s results of operations in any period presented.

Fair Value of Financial Investments: Cash and cash equivalents, accounts payable, and accrued liabilities are carried at cost, which management believes approximates fair value due to the short term maturity of these instruments. Investments, which are available-for-sale securities, are carried at fair value. Fair value of publicly traded investments is based on quoted market rates.

Inventory: Inventory is accounted for on a specific identification basis. Inventory is carried at lower of cost or realizable value.

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

Property and Equipment: Property and equipment are stated at cost, less accumulated depreciation. Depreciation on property and equipment is calculated using the straight-line method as follows:

Computers and other equipment	3 to 5 years
Furniture	10 years
Leasehold improvements	Shorter of useful life or lease term

Maintenance and repairs are expensed as incurred, while renewals and betterments are capitalized. Upon the sale or retirement of property and equipment, the accounts are relieved of the cost and the related accumulated depreciation, and any resulting gain or loss is included in results of operations.

Long-Lived Assets: The Company currently evaluates long-lived assets, including intangible assets, for impairment when events or changes indicate, in management' s judgment, that the carrying value of such assets may not be recoverable. The determination of whether an impairment has occurred is based upon management' s estimate of undiscounted future cash flows attributable to the assets as compared to the carrying value of the assets. If an impairment has occurred, the amount of the impairment recognized is determined by estimating the fair value of the assets and recording a write-down to reduce the related asset to its estimated fair value.

Capitalization of Software Development Costs: The Company follows the working model approach to determine technological feasibility of its products. Costs that are incurred subsequent to establishing technological feasibility are immaterial and, therefore, the Company expenses all costs associated with the development of its products as such costs are incurred.

Employee Stock-Based Compensation: The Company accounts for its stock option plans and employee stock purchase plan under the recognition and measurement principles of Accounting Principles Board Opinion ("APB") No. 25, Accounting for Stock Issued to Employees," and related Interpretations. Under APB No. 25, no stock-based compensation is reflected in net income (loss), as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant and the related number of shares granted is fixed at that point in time. The following table illustrates the effect on net income (loss) and earnings (loss) per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" (see Note 10, "Stock Option and Purchase Plans"):

	Year Ended January 31,		
	2005	2004	2003
Net income (loss) as reported	$ (5,805)	$ (4,861)	$ 124
Stock-based compensation, net of tax	(465)	(1,506)	(3,275)
Proforma net loss	$ (6,270)	$ (6,367)	$ (3,151)
Net income (loss) per share as reported:			
Basic	$ (0.37)	$ (0.31)	$ 0.01
Diluted	$ (0.37)	$ (0.31)	$ 0.01
Proforma net loss per share:			
Basic	$ (0.39)	$ (0.41)	$ (0.21)
Diluted	$ (0.39)	$ (0.41)	$ (0.21)

In determining the fair value, the Company used the Black-Scholes model, assumed no dividend per year, used expected lives ranging from 2 to 10 years, expected volatility of 75.0%, 71.7%, and 84.8% for the years ended January 31, 2005, 2004, and 2003, respectively, and risk free interest rates of 3.47%, 2.97%, and 3.71% for the years ended January 31, 2005, 2004, and 2003, respectively. The weighted average per share fair value of options granted during the year with exercise prices equal to market price on the date of grant was $0.81, $1.39, and $0.82 per share for the years ended January 31, 2005, 2004, and 2003, respectively.

Revenue Recognition: The Company recognizes revenues in accordance with Statement of Position 97-2 “Software Revenue Recognition” as amended by Statement of Position 98-9.

Development license revenues from the licensing of source code or software development kits (“SDKs”) for the Company’ s standard products are recognized upon delivery to and acceptance by the customer of the software if no significant modification or customization of the software is required and collection of the resulting receivable is probable. If modification or customization is essential to the functionality of the software, the development license revenues are recognized over the course of the modification work.

The Company also enters into engineering services contracts with certain of its OEMs to provide a turnkey solution, adapting the Company’ s software and supporting electronics to specific OEM requirements. Revenues on such contracts are recognized over the course of the engineering work on a percentage-of-completion basis. Progress-to-completion under percentage-of-completion is determined based on direct costs, consisting primarily of labor and materials, expended on the arrangement. The Company provides for any anticipated losses on such contracts in the period in which such losses are first determinable. At January 31, 2005 and 2004, the Company had no significant loss contracts. The Company also provides engineering support based on a time-and-material basis. Revenues from this support are recognized as the services are performed.

Recurring licensing revenues are derived from per unit fees paid by the Company’ s customers upon manufacturing and subsequent commercial shipment of products incorporating Peerless technology and certain third party technology, of which the Company is a sub-licensor. These recurring licensing revenues are recognized on a per unit basis as products are shipped commercially. In certain cases, the Company may sell a block license, that is, a specific quantity of licensed units that may be shipped in the future, or the Company may require the customer to pay minimum royalty commitments. Associated payments are typically made in one lump sum or extend over a period of four or more quarters. The Company generally recognizes revenues associated with block licenses and minimum royalty commitments on delivery and acceptance of software, when collection of the resulting receivable is probable, when the fee is fixed and determinable, and when the Company has no future obligations. In cases where block licenses or minimum royalty commitments have extended payment terms and the fees are not fixed and determinable, revenue is recognized as payments become due. Further, when earned royalties exceed minimum royalty commitments, revenues are recognized on a per unit basis as products are shipped commercially.

For fees on multiple element arrangements, values are allocated among the elements based on vendor specific objective evidence of fair value (“VSOE”). If VSOE does not exist, all revenue for the arrangement is deferred until the earlier of the point at which such VSOE does exist or all elements of the arrangement have been delivered. The Company generally establishes VSOE based upon standalone sales of similar products or services. If an arrangement includes software and service elements, a determination is made as to whether the service element can be accounted for separately as services are performed.

The Company derives revenues from the sale of controllers for MFP devices. Peerless sells its controllers to certain OEM dealers for distribution to end users. Because it is a relatively new product, the Company has been unable to establish a history regarding returns of the products shipped. Therefore, the Company recognizes revenue only upon sales through to end users.

Deferred revenue consists of prepayments of licensing fees, payments billed to customers in advance of revenue recognized on engineering services or support contracts, and shipments of controllers that have not

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

been sold to end users. Unbilled receivables arise when the revenue recognized on engineering support or block license contracts exceeds billings due to timing differences related to billing milestones as specified in the contract.

Research and Development Costs: Research and development costs are generally expensed as incurred. Costs to purchase software from third-parties for research and development that have identifiable alternative future uses (in research and development projects or otherwise) are capitalized as intangible assets and amortized over their expected useful life (see Note 6).

Advertising Costs: Advertising costs are expensed as incurred in accordance with Statement of Position 93-7 "Reporting on Advertising Costs." Advertising expenses are recorded in sales and marketing expense and were immaterial to the results of operations for all periods presented.

Income Taxes: The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred income taxes are recognized for the tax consequences in future years resulting from differences between the tax bases 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 reverse. Valuation allowances are established, when necessary, to reduce deferred income tax assets to the amount expected to be realized. Income tax provision is the tax payable for the period and the change during the period in net deferred income tax assets and liabilities.

Comprehensive Loss: In accordance with SFAS No. 130, "Reporting Comprehensive Income," all components of comprehensive loss, including net losses, are reported in the financial statements in the period in which they are recognized. Comprehensive loss is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. The Company' s other comprehensive income for fiscal years January 31, 2005 and 2004 consisted of foreign currency translation gains and is reported in stockholders' equity.

Earnings Per Share: Basic earnings per share ("basic EPS") is computed by dividing net income (loss) available to common stockholders (the numerator) by the weighted average number of common shares outstanding (the denominator) during the period. The computation of diluted earnings per share ("diluted EPS") is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares include outstanding options under the Company' s employee stock option plan (which are included under the treasury stock method) and any outstanding convertible securities. A reconciliation of basic EPS to diluted EPS is presented in Note 9 to the Company' s financial statements.

Reclassifications: Certain previously reported financial information has been reclassified to conform to the fiscal 2005 presentation.

Foreign Currency Translation: The financial statements of the Company' s non-U.S. subsidiary are translated into U.S. dollars in accordance with SFAS No. 52, "Foreign Currency Translation." The assets and liabilities of the Company' s non-U.S. subsidiary whose "functional" currencies are other than the U.S. dollar are translated at current rates of exchange. Revenue and expense items are translated at the average exchange rate for the year. The resulting translated adjustments are recorded directly into accumulated other comprehensive income (loss). Transaction gains and losses are included in net income in the period they occur. Foreign currency translation and transaction gains and losses have not been significant in any period presented.

Recent Accounting Pronouncements: On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation." SFAS 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and amends FASB Statement No. 95, "Statement of Cash Flows." Generally, the approach in SFAS 123(R) is similar to the approach described in Statement 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statement of operations based on their fair values. Pro forma disclosure is no longer an alternative.

SFAS 123(R) must be adopted by the Company for fiscal years beginning after December 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. The Company expects to adopt SFAS 123(R) on February 1, 2006. SFAS 123(R) permits companies to adopt its requirements using one of two methods.

The first method is a modified prospective transition method whereby a company would recognize share-based employee costs from the beginning of the fiscal period in which the recognition provisions are first applied as if the fair value-based accounting method had been used to account for all employee awards granted, modified, or settled after the effective date and to any awards that were not fully vested as of the effective date. Measurement and attribution of compensation cost for awards that are non-vested as of the effective date of SFAS 123(R) would be based on the same estimate of the grant-date fair value and the same attribution method used previously under SFAS 123.

The second adoption method is a modified retrospective transition method whereby a company would recognize employee compensation cost for periods presented prior to the adoption of SFAS 123(R) in accordance with the original provisions of SFAS 123, that is, an entity would recognize employee compensation cost in the amounts reported in the pro forma disclosures provided in accordance with SFAS 123. A company would not be permitted to make any changes to those amounts upon adoption of SFAS 123(R) unless those changes represent a correction of an error. For periods after the date of adoption of SFAS 123(R), the modified prospective transition method described above would be applied.

The Company currently expects to adopt SFAS 123(R) using the modified prospective transition method, and expects the adoption to have an effect on its results of operations similar to the amounts reported historically in the Company' s footnotes (see Note 1) under the pro forma disclosure provisions of SFAS 123.

2. Divestiture and Sale:

Netreon Divestiture and Sale:

In January 2002, the Company exchanged all of the outstanding capital stock of Netreon for 7,714 shares of Series A Preferred Stock of Netreon, Inc., a Delaware corporation ("Newco"), representing a 40.8% interest in the voting shares of Newco stock. The remaining 59.2% of the voting shares of Newco stock was held by parties external to the Company, including a former executive officer of Netreon, who is also a former member of the Company' s board of directors. The Company did not expect to realize the cost of the Netreon capital stock exchanged or costs incurred which were direct and incremental to the transaction. As a result, the Company did not record an investment in Newco and recorded a $2.3 million charge to loss on divestiture of storage operations. Among other things, this included a $947 payment made to a landlord to terminate the Company' s obligations under one of Netreon' s leases and a $420 accrual for other Netreon lease obligations to be paid by the Company through fiscal year 2005. The Company has no continuing obligation to provide funding in any form to Newco.

In February, 2003, the Company sold its remaining interest in Netreon. As a result of the sale, the Company recorded in other income a gain of $971, net of expenses, associated with this transaction in the first quarter of fiscal year 2004 (see Note 14).

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

3. Investments:

Investments available-for-sale at January 31 consisted of the following:

	2005	2004
Available-for-sale securities:		
Maturities within one year:		
Corporate debt securities	$ 1,397	$ 499
State and local government debt securities	−	403
	1,397	902
Maturities after one year through five years:		
Corporate debt securities	−	2,218
State and local government debt securities	−	421
U.S. government debt securities	−	400
	−	3,039
Maturities after ten years:		
U.S. government debt securities	−	400
Total investments	$ 1,397	$ 4,341

As of January 31, 2004, the above available-for-sale securities include $3.4 million of investments with contractual maturities greater than one year which are classified on the consolidated balance sheets as current investments, based on the Company' s intention to use these investments to fund current operations, if necessary.

The fair value of available-for-sale securities at January 31, 2005 and 2004 approximated their carrying value (amortized cost). Unrealized gains or losses on available-for-sale securities were immaterial for all periods presented.

4. Inventory

Inventory at January 31 consisted of the following:

	2005	2004
Raw material	$ 37	$ −
Finished goods	651	2
Total inventory	$ 688	$ 2

Inventory is stated at lower of cost or realizable value.

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

5. Property and Equipment:

Property and equipment at January 31 consisted of the following:

	2005	2004
Computers and other equipment	$ 8,251	$ 8,036
Furniture	494	479
Leasehold improvements	2,378	2,378
	11,123	10,893
Less, accumulated depreciation and amortization	(9,741)	(8,912)
	$ 1,382	$ 1,981

Property and equipment depreciation and amortization for the years ended January 31, 2005, 2004, and 2003 was $829, $1,018, and $1,321, respectively.

During fiscal year 2003, the Company amended the building lease of its headquarters in California, resulting in a reduction of office space. The Company recorded charges of approximately $0.7 million for costs associated with the amendment of the lease and the write-off of certain leasehold improvements.

In February 2003, a sublesee terminated a sublease that involved approximately 9,000 square feet of the Company' s California headquarters. As a result of the termination, the Company received $639 in cash and a forfeited deposit, which is included in other income. In addition, the Company received $299 in net fixed assets returned to the Company, which was classified as operating expenses, the same classification used in a prior period when a loss was recognized for the disposal of these same assets. The assets were recorded at fair market value. The total gain from the sublease termination was $938.

6. Other Assets:

In fiscal year 2004, the Company converted a royalty-bearing perpetual license to a fully paid-up perpetual license to use certain third party color technology to be incorporated into the Company' s high performance color architecture and products. The licensed technology is presently being applied in several of the Company' s research and development projects and will be incorporated into the Company' s new products. The Company determined this license has alternate future uses and has capitalized the cost as an intangible asset, included in other assets. The cost of $1,100 for this license is being amortized over a two-year period during its use on such projects and products. Accumulated amortization from the acquired prepaid licenses totaled $779 at January 31, 2005. For the years ended January 31, 2005 and 2004, the Company recorded amortization expense of $550 and $229, respectively. The remaining amortization expense of $321 will be recorded in fiscal year 2006.

7. Deferred Revenues

The Company may bill or receive payments from its customers for fees associated with product licensing, engineering services, or maintenance agreements in advance of the Company' s completion of its contractual obligations. Such billings or payments, in accordance with the Company' s revenue recognition policies, are deferred, and are recognized as revenue when the Company has performed its contractual obligations related to the billings or payments.

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

Deferred revenues consisted of the following at January 31:

	2005	2004
Product licensing	$ 25	$ 63
Engineering services and maintenance	767	1,260
Other	105	−
	$ 897	$ 1,323

8. Income Taxes:

The income tax provision for the years ended January 31 consisted of:

	2005	2004	2003
Current:			
Federal	$ −	$ (980)	$ (1,621)
State	1	1	1
Foreign	150	1,675	2,110
	$ 151	$ 696	$ 490

The foreign tax provision was comprised of foreign withholding taxes on license fees and royalty payments. On July 1, 2004, a new tax treaty between Japan and the United States went into effect. The new treaty generally eliminates the requirement of the Company' s Japanese customers to withhold income taxes on royalty payments due to Peerless. The impact was to nearly eliminate the Company' s provision for income taxes in the period since the treaty went into effect.

The Company' s current income tax provision was benefited by approximately $980 and $1,080 for fiscal years 2004 and 2003, respectively, for the elimination of certain pending income tax matters and related liabilities. At January 31, 2005, the Company has no remaining liabilities related to these matters.

Temporary differences for the years ended January 31, consisted of:

	2005	2004
Deferred tax assets:		
Net operating loss carryforwards	$ 5,130	$ 2,735
Accrued liabilities	308	326
Allowance for doubtful accounts	48	56
Property and equipment	560	119
Inventory	83	−
Deferred expenses	197	171
Tax credit carryforwards	9,353	6,862
Other	2	20
Total deferred tax assets	15,681	10,289
Deferred tax liabilities:		
State income taxes	(1)	(1)
Subtotal	15,680	10,288
Valuation allowance	(15,680)	(10,288)
Net deferred income tax asset	$ −	$ −

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

The Company provided a valuation allowance on its net deferred tax assets because of the uncertainty with respect to the Company' s ability to generate future taxable income to realize the deferred tax assets.

A portion of the valuation allowance is related to stock option compensation deductions incurred in the Company' s net operating loss carryforwards. If and when the Company reduces any portion of the valuation allowance related to stock option compensation deduction, the benefit will be added to stockholders' equity, rather than being shown as a reduction of future income tax expense.

The provision for income taxes for the years ended January 31, differed from the amount that would result from applying the federal statutory rate as follows:

	2005	2004	2003
Statutory federal income tax rate	(34.0)%	(34.0)%	34.0 %
Foreign provision	2.7	40.2	353.9
Other nondeductible expenses	0.3	0.5	2.5
State tax	(5.8)	(4.2)	5.8
Change in valuation allowance	50.9	25.5	(137.4)
Other	(11.4)	(11.3)	(176.9)
Provision for income taxes	2.7 %	16.7 %	81.9 %

As of January 31, 2005, the Company had net operating loss carryforwards available to reduce future federal and state income of approximately $13,673 and $8,248, respectively, which will begin to expire in fiscal years 2021 for federal and 2006 for state. In addition, as of January 31, 2005, the Company had tax credit carryforwards available to reduce future income tax liabilities of approximately $9,353, which will begin to expire in fiscal year 2006. Utilization of the net operating loss and tax carryforwards will be subject to an annual limitation if a change in the Company' s ownership should occur as defined by Section 382 and Section 383 of the Internal Revenue Code.

9. Earnings (Loss) Per Share:

Earnings (loss) per share for the years ended January 31, is calculated as follows:

	2005			2004			2003		
	Net Loss	Shares	Per Share Amount	Net Loss	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic EPS									
Earnings (loss) available to common stock holders	$ (5,805)	15,891	$ (0.37)	$ (4,861)	15,575	$ (0.31)	$ 124	15,282	$ 0.01
Effect of Dilutive Securities									
Options							−	440	
Diluted EPS									
Earnings (loss) available to common stockholders with assumed conversions	$ (5,805)	15,891	$ (0.37)	$ (4,861)	15,575	$ (0.31)	$ 124	15,722	$ 0.01

The Company has certain common stock options and warrants that are not included in the calculation of diluted earnings (loss) per share in fiscal years 2005 and 2004 because the effects are antidilutive.

(in thousands, except per share amounts)

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10. Stock Option and Purchase Plans:

1992 Stock Option Plan: During 1992, the Board of Directors authorized the 1992 Stock Option Plan for the purpose of granting options to purchase the Company' s common stock to employees, directors and consultants. The Board of Directors determines the form, term, option price and conditions under which each option becomes exercisable. Options to purchase a total of 1,055 shares of common stock have been authorized by the Board under this plan.

The following represents option activity for the years ended January 31 under the 1992 Stock Option Plan:

	2005		2004		2003	
	Number of Options	Weighted Average Per Share Exercise Price	Number of Options	Weighted Average Per Share Exercise Price	Number of Options	Weighted Average Per Share Exercise Price
Options outstanding at beginning of year	21	$ 1.56	22	$ 1.51	29	$ 1.29
Options granted	−		−		−	
Options exercised	−		(1)	$ 0.53	(7)	$ 0.53
Options forfeited	(3)	$ 1.43	−		−	
Options outstanding at year-end	18	$ 1.59	21	$ 1.56	22	$ 1.51
Options exercisable at year-end	18	$ 1.59	21	$ 1.56	22	$ 1.51
Options available for future grant	−					
Weighted average remaining contractual life in years	1.0					
Range of per share exercise prices for options outstanding at year-end	$ 1.43 - $1.65					

Incentive Plan: In May 1996, the Board adopted the Company' s 1996 Stock Option Plan. The Company' s 1996 Equity Incentive Plan (the "Incentive Plan") was adopted by the Board of Directors in July 1996 as an amendment and restatement of the Company' s 1996 Plan. At that time, the Board had authorized and reserved an aggregate of 1,267 shares of common stock for issuance under the Incentive Plan. Additional shares of common stock were authorized and reserved for issuance under the Incentive Plan in June 1998, June 1999, June 2001, and June 2003 in the amounts of 1,200, 750, 750, and 700 shares, respectively.

The Incentive Plan provides for the grant of incentive stock options to employees and nonstatutory stock options, restricted stock purchase awards and stock bonuses to employees, directors and consultants. The terms of stock options granted under the Incentive Plan generally may not exceed 10 years. The exercise price of options granted under the Incentive Plan is determined by the Board of Directors, provided that the exercise price for an incentive stock option cannot be less than 100% of the fair market value of the common stock on the date of the option grant and the exercise price for a nonstatutory stock option cannot be less than 85% of the fair market value of the common stock on the date of the option grant. Options granted under the Incentive Plan vest at the rate specified in each optionee' s option agreement.

During 1994, the Auco, Inc. Board of Directors authorized the 1994 Stock Option Plan. The terms and conditions of this plan were generally the same as those of the Peerless Incentive Plan except options issued under the Auco plan were exercisable immediately subject to repurchase rights held by Auco. In June 1999, upon completion of the merger between Peerless and Auco, the Auco options were converted to options under the Company' s Incentive Plan.

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

The following represents option activity under the Incentive Plan for the years ended January 31:

	2005		2004		2003	
	Number of Options	Weighted Average Per Share Exercise Price	Number of Options	Weighted Average Per Share Exercise Price	Number of Options	Weighted Average Per Share Exercise Price
Options outstanding at beginning of year	3,081	$ 2.71	3,121	$ 2.82	2,735	$ 3.68
Options granted	963	$ 1.33	266	$ 2.34	794	$ 1.23
Options exercised	(55)	$ 0.73	(121)	$ 0.78	(66)	$ 0.89
Options forfeited	(234)	$ 3.86	(185)	$ 1.65	(342)	$ 3.12
Options outstanding at year-end	3,755	$ 2.30	3,081	$ 2.70	3,121	$ 2.82
Options exercisable at year-end	2,176	$ 2.99	1,849	$ 3.60	1,532	$ 4.32
Options available for future grant	284					
Weighted average remaining contractual life in years	6.7					
Range of per share exercise prices for options outstanding at year-end	$ 0.39-$22.38					

For various price ranges, weighted average characteristics of outstanding stock options under the Incentive Plan at January 31, 2005 were as follows:

	Outstanding Options			Exercisable Options	
	Shares Under Option	Weighted Average Remaining Life (Years)	Weighted Average Per Share Exercise Price	Shares Under Option	Weighted Average Per Share Exercise Price
$0.00 to $1.00	609	5.8	$ 0.74	471	$ 0.73
$1.00 to $1.25	477	6.8	$ 1.16	313	$ 1.17
$1.25 to $1.50	1,440	8.6	$ 1.33	309	$ 1.37
$1.50 to $2.00	482	4.6	$ 1.65	458	$ 1.64
$2.00 to $2.25	110	8.1	$ 2.10	29	$ 2.10
$2.25 to $5.00	346	5.2	$ 3.68	305	$ 3.76
$5.00 to $22.38	291	3.6	$ 11.76	291	$ 11.76
Total	3,755			2,176	

Other Stock Options: During fiscal year 2005, the Company granted stock options to two non-employees of the Company in connection with an agreement with the non-employees to provide services to the Company. The stock options are for the purchase 25 shares at an exercise price of $3.27 and 25 shares at an exercise price of $4.27. The options are fully vested and expire on May 24, 2014. The fair value of the options was recorded as an operating expense at the time of grant. The fair value of the options was $31 and was determined using the Black-Scholes method.

In connection with an employee separation agreement entered into during fiscal year 2005, the Company accelerated the vesting and extended the terms of stock options held by this employee. The Company recorded compensation expense of $35 related to these modifications.

Employee Stock Purchase Plan: In July 1996, the Company' s Board of Directors approved the Employee Stock Purchase Plan (the "Purchase Plan") covering an aggregate of 300 shares of the Company' s common stock. An additional 500 shares were approved by the stockholders in June 2000, with an additional 1,000 shares approved in June 2002. Under the Purchase Plan, the Board of Directors may authorize participation by eligible employees, including officers, in periodic offerings following the adoption of the Purchase Plan. The offering period for any offering will be no more than 27 months. Plan offering periods have been six months since the inception of the plan. Employees are eligible to participate if they are employed by the Company or an affiliate of the Company designated by the Board of Directors and meet eligibility standards established by the Board of Directors. Employees who participate in an offering can have up to 15% of their earnings withheld pursuant to the Purchase Plan and applied, on specified dates determined by the Board of Directors, to the purchase of shares of common stock. The price of common stock purchased under the Purchase Plan will be equal to 85% of the lower of the fair market value of the common stock on the commencement date or the purchase date of each offering period. Employees may end their participation in the offering at any time during the offering period, and participation ends automatically on termination of employment with the Company and its affiliates. The Purchase Plan will terminate at the Board of Directors' discretion.

Under the Purchase Plan, during the years ended January 31, 2005 and 2004, employees purchased 251 and 294 shares of common stock at weighted average per share prices of $1.35 and $1.09, respectively. No purchases were made by employees during fiscal year 2003. As of January 31, 2005, 633 shares remained available for purchase under the Purchase Plan.

Warrants: On October 27, 2004, the Company issued to Silicon Valley Bank (SVB) warrants to purchase 31 shares of the Company' s common stock at a warrant price of $1.31 per share. The warrants were issued in connection with the establishment of a credit facility with SVB for borrowings to be made against the Company' s receivables (See Note 18). The warrants expire on October 27, 2009. As of January 31, 2005, all warrants remained outstanding. The fair value of the warrants was capitalized as a financing cost and is being amortized over the one-year term of the credit facility. The fair value of the warrants was $24 and was determined using the Black-Scholes method.

11. Shareholder Rights Plan:

In October 1998, the Board of Directors of the Company adopted a stockholder rights plan, as set forth in the Rights Agreement, dated as of October 7, 1998, by and between the Company and Wells Fargo Shareowner Services, a division of Wells Fargo Bank Minnesota, N.A., formerly known as Norwest Shareowner Services, as rights agent. Pursuant to the Rights Agreement, one right was issued for each share of the Company' s 11,037 outstanding shares of common stock as of October 15, 1998. Each of the Rights entitles the registered holder to purchase, from the Company, one one-thousandth of a share of Series A Junior Participating Preferred Stock at a price of $35.50 per one one-thousandth of a share. The Rights generally will not become exercisable unless and until, among other things, any person or group not approved by the Board of Directors acquires beneficial ownership of 15% or more of the Company' s outstanding common stock or commences a tender offer or exchange offer which would result in a person or group beneficially owning 15% or more of the Company' s outstanding common stock. Upon the occurrence of certain events, each holder of a Right, other than such person or group, would thereafter have the right to purchase, for the then exercise price of the Right, shares of common stock of the Company or a corporation or other entity acquiring the Company, having a value equal to two times the exercise price of the Right. The Rights are redeemable by the Company under certain circumstances at $0.01 per Right and will expire, unless earlier redeemed or extended, on October 15, 2008.

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

12. Employee Savings Plan:

The Company maintains an employee savings plan that qualifies under Section 401(k) of the Internal Revenue Code (the “Code”) for all of the Peerless full-time employees. The plan allows employees to make specified percentage pretax contributions up to the maximum dollar limitation prescribed by the Code. The Company has the option to contribute to the plan up to a maximum of $2,000 per employee per year. Company contributions to the plan during the years ended January 31, 2005, 2004, and 2003 were $163, $176, and $151, respectively.

13. Segment Reporting:

The Company operates in one reportable business segment, Imaging. Peerless provides software-based digital imaging and networking technology for digital document products and provides directory and management software for networked storage devices and integrates proprietary software into enterprise networks of original equipment manufacturers.

The Company’ s long-lived assets are located principally in the United States. The Company’ s revenues for the years ended January 31, which are transacted in U.S. dollars, are derived based on sales to customers in the following geographic regions:

	Years Ended January 31,		
	2005	2004	2003
United States	$ 3,384	$ 3,255	$ 3,599
Japan	19,673	21,912	27,584
Other	21	87	574
	$ 23,078	$ 25,254	$ 31,757

14. Other Income:

On February 20, 2003, the Company sold its remaining interest in Netreon. As a result of the sale, the Company recorded in other income a gain of $971, net of expenses, associated with this transaction in the first quarter of fiscal year 2004.

On February 28, 2003, a sublessee terminated a sublease that involved approximately 9,000 square feet of the Company’ s El Segundo, California headquarters. As a result of the sublease termination, the Company recorded in other income a gain of $639 for cash and a forfeited deposit associated with this transaction in the first quarter of fiscal year 2004.

PEERLESS SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS − (Continued)
(in thousands, except per share amounts)

15. Commitments:

Operating Leases: The Company leases its offices and certain operating equipment under operating leases that expire through fiscal year 2011. The principal operating leases covering the Company' s office space contain certain predetermined rent increases calculated at the inception of the lease based on the lessor' s estimate of expected increases in the fair market value of the leased space. These leases provide for renewal options of one to five years, at then fair rental value. Future minimum rental payments under long-term operating leases for the years ending January 31 are as follows:

	Operating Leases
2006	$ 1,243
2007	1,399
2008	1,307
2009	136
2010	142
Thereafter	49
	$ 4,276

Total rental expense, net of sublease income, was $1,369, $1,372, and $1,226 for the years ended January 31, 2005, 2004, and 2003, respectively.

The Company has outstanding purchase orders of approximately $155 for materials and services at the end of fiscal year 2005.

16. Risks and Uncertainties:

Concentration of Credit Risk: The Company had cash and certificates of deposit on deposit at banks at certain times throughout the year that was in excess of federally insured limits.

The Company' s credit risk in accounts receivable, which are generally not collateralized, is concentrated with customers which are OEMs of laser printers and printer peripheral technologies. The financial loss, should a customer be unable to meet its obligation to the Company, would be equal to the recorded accounts receivable. At January 31, 2005, three customers collectively represented 69% of total trade accounts receivable and at January 31, 2004, four customers collectively represented 86%. For the years ended January 31 the following customers, not necessarily the same from year to year, represented greater than ten percent of total revenues:

	2005		2004		2003	
Customer A	$ 6,567	28%	$ 7,688	30%	$ 7,458	24%
Customer B	2,984	13%	4,666	19%	7,448	23%
Customer C	2,653	12%	2,946	12%	−	
Customer D	2,400	10%	−		−	
	$ 14,604	63%	$ 15,300	61%	$ 14,906	47%

A significant portion of the Company' s revenue is generated from the sale of block licenses. Block license revenue represented 56%, 63%, and 65% of total revenue for the fiscal years 2005, 2004, and 2003.

Litigation: The Company is involved from time to time in various claims and legal actions incident to its operations, either as plaintiff or defendant. In the opinion of management, after consulting with legal counsel, no claims are currently expected to have a material adverse effect on the Company' s financial position, operating results, or cash flows.

17. Related Party Transactions:

In fiscal years 2005 and 2004, the Company engaged a consulting firm controlled by an officer of the Company to provide sales and marketing services. Sales and marketing expenses for the years ended January 31, 2005 and 2004 included $115 and $220, respectively, for the services performed by this related entity. No such expenses were incurred in fiscal year 2003. No significant balances were owed to the entity at January 31, 2005 or 2004.

18. Credit Facility:

On October 27, 2004, the Company entered into a credit facility with Silicon Valley Bank. The facility allows the Company to borrow up to a maximum of $4.0 million against qualified accounts receivable. Any borrowings against this facility would be made at prime plus 2.75% and are repaid with the collection of the individual receivable financed. The Company is required to maintain a quarterly tangible net worth. The cost of the facility, including the fair value of warrants issued (see Note 10), was $69, which has been capitalized and will be amortized over the term of the agreement, which is one year. At January 31, 2005, there were no outstanding amounts owed against the facility, and, based on eligible receivables as of that date, $2.0 million was available for borrowing.

19. Subsequent Event:

On March 1, 2005, the Company entered into a Memorandum of Understanding ("MOU") with Kyocera Mita Corporation ("Kyocera Mita") to provide non-exclusive engineering services and high-performance imaging technologies for use in a forthcoming line of Kyocera Mita printers and multi-function products. Pursuant to the MOU, Kyocera Mita has agreed to pay Peerless an aggregate of $24.0 million, which will be paid in $2.0 million quarterly payments over the initial three-year term of the MOU with the first payment to be made no later than April 29, 2005. Peerless is also eligible for certain performance incentives and will be due license fees from Kyocera Mita for all Peerless and its third-party technologies that are incorporated into Kyocera Mita products. The MOU, which states that it is binding, is effective as of February 1, 2005, and extends to January 31, 2008. The MOU will automatically renew on an annual basis after January 31, 2008, unless terminated by either party.

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SCHEDULE II − VALUATION AND QUALIFYING ACCOUNTS

Allowances for Uncollectible Accounts Receivable:	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Deductions(a)	Balance at End of Period
	(In thousands)			
Year Ended January 31, 2003				
Reserves deducted from assets to which they apply:				
Allowances for uncollectible accounts receivable	$ 100	$ 110	$ (8)	$ 202
Year Ended January 31, 2004				
Reserves deducted from assets to which they apply:				
Allowances for uncollectible accounts receivable	$ 202	$ (61)	$ −	$ 141
Year Ended January 31, 2005				
Reserves deducted from assets to which they apply:				
Allowances for uncollectible accounts receivable	$ 141	$ 15	$ (31)	$ 125

(a) Accounts written off, net of recoveries.

EXHIBIT INDEX

Exhibit Number	
3 .1(1)	Certificate of Incorporation of the Company.
3 .2(9)	Amended and Restated Bylaws of the Company.
4 .1	Instruments defining the rights of security holders. Reference is made to Exhibits 3.1 and 3.2.
4 .2(4)	Rights Agreement, dated October 7, 1998, between the Company and Wells Fargo Shareowner Services, a division of Wells Fargo Bank Minnesota, N.A., formerly known as Norwest Shareowner Services, as Rights Agent.
10.1(10)(2)	1996 Equity Incentive Plan, as amended and form of stock option agreements thereunder.
10.2(11)(2)	1996 Employee Stock Purchase Plan, as amended.
10.3(1)(3)	Reference Post Appendix No. 2 to the Adobe Third Party License dated February 11, 1993.
10.4(1)	Amendment No. 1 to the Adobe Third Party License dated November 29, 1993.
10.5(1)(3)	PCL Development and License Agreement (the "PCL License") dated June 14, 1993, between the Registrant and Adobe.
10.6(1)(3)	Amendment No. 1 to the PCL License dated October 31, 1993.
10.7(1)(3)	Letter Modification to the PCL License dated August 5, 1994.
10.8(1)(3)	Addendum No. 1 to the PCL License dated March 31, 1995.
10.9(1)(3)	Letter Modification to the PCL License dated August 30, 1995.
10.10(1)	Lease Agreement between the Company and Continental Development Corporation dated February 6, 1992, and Addendum, dated February 6, 1992.
10.11(1)	First Amendment to Office Lease dated December 1, 1995, between the Company and Continental Development Corporation.
10.12(5)	Second Amendment to Office Lease dated April 8, 1997, between the Company and Continental Development Corporation.
10.13(5)	Third Amendment to Office Lease dated December 16, 1997, between the Company and Continental Development Corporation.
10.14(6)	Fourth Amendment to Office Lease dated April 22, 1998, between the Company and Continental Development Corporation.
10.15(7)	Agreement and Plan of reorganization and Merger by and among Peerless Systems Corporation, Auco Merger and Auco, Inc. dated as of April 6, 1999.
10.16(8)	Marubun Supplier/Distribution Agreement dated December 14, 1999.
10.17(8)	Lease PSN McKelvy Family Trust (386 Main Street) Standard Industrial/Commercial Single-Tenant dated March 14, 1997.
10.18(8)	Lease PSIP Kent Centennial Limited Partnership dated January 31, 1996.
10.19(2)(12)	Form of Indemnification Agreement, effective as of March 12, 2001.

10.20(13)	Settlement Agreement and Mutual Release dated April 11, 2001 between Peerless Systems Corporation and Gordon L. Hanson.
10.21(9)	Settlement Agreement and Mutual Release, effective as of April 27, 2001, by and among the State of Wisconsin Investment Board, Peerless Systems Corporation and Edward A. Gavaldon.
10.22(14)	Series A Preferred Stock Purchase Agreement dated January 29, 2002 by and among Netreon, Inc., a Delaware corporation, Netreon, Inc., a California corporation and each of the several purchasers named therein.
10.23(14)	Series A Preferred Stock Contribution Agreement dated January 29, 2002 by and between Netreon, Inc., a Delaware corporation and Peerless Systems Corporation.

Exhibit Number	
10.24(3)(15)	Postscript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and the Company effective as of July 23, 1999.
10.25(3)(15)	Custom Sales Agreement between the Company and International Business Machines effective as of April 23, 2001.
10.26(3)(15)	Master Technology License Agreement dated January 16, 2000 between Konica Corporation and Peerless Systems Corporation.
10.27(3)(15)	License Software Addendum #1 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 16, 2000.
10.28(3)(15)	License Software Addendum #2 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 19, 2000.
10.29(3)(15)	License Software Addendum #3 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of July 21, 2000.
10.30(3)(15)	License Software Addendum #4 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of March 1, 2001.
10.31(3)(15)	License Software Addendum #5 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of July 1, 2001.
10.32(3)(15)	License Software Addendum #7 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 1, 2002.
10.33(3)(15)	License Software Addendum #8 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 1, 2002.
10.34(3)(15)	License Software Addendum #9 to Master Technology License Agreement by and between Konica Corporation and the Company effective as of January 1, 2002.
10.35(15)	Master Technology License Agreement dated April 1, 1997 between Kyocera Corporation and Peerless Systems Corporation.
10.36(3)(15)	Licensed Software Addendum #1 to Master Technology License Agreement by and between Kyocera Corporation and the Company effective as of December 28, 1999.
10.37(3)(15)	Amendment #3 to Licensed Software Addendum #1 to Master Technology License Agreement by and between Kyocera Corporation and the Company effective as of September 28, 2001.
10.38(3)(15)	Licensed Software Addendum #3 to Master Technology License Agreement by and between Kyocera Mita Corporation and the Company effective as of May 1, 2002.
10.39(3)(15)	Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc.
10.40(3)(15)	Licensed System Addendum No. 1 to Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc.
10.41(3)(15)	Licensed System Addendum No. 2 to Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc.
10.42(3)(15)	Licensed System Addendum No. 3 to Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc. effective as of August 25, 2000.

10.43(3)(15)	Attachment #1 to Licensed System Addendum #3 by and between Oki Data Corporation and Peerless Systems Imaging Products, Inc. dated March 1, 2001.
10.44(3)(15)	Attachment #2 to Licensed System Addendum #3 by and between Oki Data Corporation and Peerless Systems Imaging Products, Inc. dated July 1, 2001.
10.45(3)(15)	Licensed System Addendum No. 4 to Master Technology License Agreement between Oki Data Corporation and Peerless Systems Imaging Products, Inc. effective as of February 1, 2002.
10.46(15)	Master Technology License Agreement dated April 1, 2000 between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc.

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10.47(3)(15)	Licensed System Addendum #1 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. dated April 1, 2000.
10.48(3)(15)	Licensed System Addendum #2 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc.
10.49(3)(15)	Licensed System Addendum #3 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc.
10.50(3)(15)	Attachment #1 to Licensed System Addendum #3 by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. dated May 1, 2001.
10.51(3)(15)	Attachment #2 to Licensed System Addendum #3 by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. dated July 23, 2001.
10.52(3)(15)	Licensed System Addendum #4 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. effective as of October 19, 2001.
10.53(3)(15)	Licensed System Addendum #5 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. effective as of December 1, 2001.
10.54(3)(15)	Licensed System Addendum #6 to Master Technology License Agreement by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. effective as of April 30, 2002.
10.55(3)(15)	Nest Office SDK Development and Reseller Agreement Statement of Work 8 to BDA No. N-A-1 between and Novell, Inc. and Peerless Systems Networking effective as of August 17, 1999.
10.56(3)(15)	Amendment No. 1 to Nest Office SDK Development and Reseller Agreement Statement of Work 8 to BDA No. N-A-1 between and Novell, Inc. and Peerless Systems Networking effective as of August 17, 1999.
10.57(15)	Business Development Agreement by and between Novell and Auco, Inc effective as of September 6, 1996.
10.58(16)	Amendment No. 4 to Licensed System Addendum No. 4 dated February 1, 2002 by and between Oki Data Corporation and Peerless Systems Imaging Products, Inc. dated September 1, 2002.(15)
10.59(16)	Amendment No. 3 to Postscript Software Development Agreement by and between Adobe Systems Incorporated and the Company dated October 25, 2002.
10.60(3)(17)	Amendment No. 1 to Licensed System Agreement No. 7 dated November 1, 2001 by and between Konica Corporation and Peerless Systems Corporation dated January 1, 2003.
10.61(3)(17)	Licensed System Agreement Addendum No. 10 to Master Technology License Agreement dated January 16, 2000 by and between Konica Corporation and Peerless Systems Corporation dated January 17, 2003.
10.62(3)(17)	Licensed System Addendum #8 to Master Technology License Agreement dated April 1, 2000 by and between Seiko Epson Corporation and Peerless Systems Imaging Products, Inc. effective as of January 6, 2003.
10.63(3)(18)	Amendment No. 4 to the Postscript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of July 31, 2003.
10.64(3)(18)	Amendment No. 10 to the Postscript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of July 31, 2003.
10.65(3)(19)	Amendment No. 5 to Licensed System Addendum No. 4 between Oki Data Corporation and Peerless Systems Imaging Products, Inc. dated February 1, 2002.

Exhibit Number	
10.66(3)(19)	Amendment No. 8 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of September 30, 2003.
10.67(3)(19)	Amendment No. 9 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of September 15, 2003.
10.68(3)(19)	Amendment No. 12 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of September 22, 2003.
10.69(20)	Licensed Software Addendum No. 14 to Master Technology License Agreements dated January 16, 2000 and June 12, 1997 by and between KonicaMinolta Business Technologies, Inc. and Peerless Systems Corporation, effective as of October 31, 2003
10.70(20)	Amendment #2 to the LSA #9 by and between KonicaMinolta Business Technologies, Inc. and Peerless Systems Corporation, effective as of November 1, 2003
10.71(20)	Amendment No. 5 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of December 16, 2003.
10.72(20)	Amendment No. 6 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of July 31, 2002.
10.73(20)	Amendment No. 7 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of May 22, 2003.
10.74(20)	Amendment No. 11 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of February 9, 2004.
10.75(20)	Amendment No. 14 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of December 16, 2003.
10.76(20)	Amendment No. 15 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of January 6, 2004.
10.77(2)(20)	Change in Control Agreement of Chief Executive Officer.
10.78(2)(20)	Form of Change in Control Agreement of certain members of senior management.
10.79(2)(20)	Form of Transaction Incentive Plan of certain members of senior management.
10.80(21)	Amendment No. 16 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of January 6, 2004.
10.81(21)	Licensed Software Addendum #5 to Master Technology License Agreement dated April 1, 1997, entered into as of February 17, 2004.
10.82(21)	Amendment No. 19 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of April 1, 2004.
10.83(22)	Amendment to Lease between BIT Holdings Forty-Eight, Inc. and Peerless Systems Imaging Products, Inc. as of October 1, 2004.
10.84(22)	Amendment No. 17 to the Postscript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, Effective as of 15 October, 2004.

10.85(22) Silicon Valley Bank Loan and Security Agreement between Silicon Valley Bank and Peerless Systems Corporation dated October 27, 2004.

Exhibit Number	
10.86(23)	Memorandum of Understanding by and between Kyocera Mita Corporation and Peerless Systems Corporation, effective as of February 1, 2005.
10.87(23)	Amendment No. 21 to the PostScript Software Development License and Sublicense Agreement between Adobe Systems Incorporated and Peerless Systems Corporation, effective as of January 1, 2005.
10.88	Confidential Separation Agreement and Mutual Release by and between Denis Retoske and Peerless Systems Corporation dated June 4, 2004.
10.89	Peerless/Consultant Consulting Agreement by and between Denis Retoske and Peerless Systems Corporation dated June 4, 2004.
10.90	Notice of Termination of Consulting Relationship Letter from Peerless Systems Corporation to Denis Retoske dated March 28, 2005.
21	Registrant' s Wholly-Owned Subsidiaries.
23.1	Consent of Independent Registered Public Accounting Firm.
24.1	Power of Attorney. Reference is made to the signature page to this Annual Report on Form 10-K.
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Previously filed in the Company' s Registration Statement on Form S-1 (File No. 333-09357), as amended and incorporated herein by reference.

(2) Management contract or compensatory plan or arrangement.

(3) Subject to a Confidential Treatment Order.

(4) Previously filed in the Company' s Current Report on Form 8-K, filed October 13, 1999, and incorporated herein by reference.

(5) Previously filed in the Company' s 1998 Annual Report filed on Form 10-K, filed April 24, 1998, and incorporated herein by reference.

(6) Previously filed in the Company' s 1999 Annual Report filed on Form 10-K, filed April 26, 1999, and incorporated herein by reference.

(7) Previously filed in the Company' s Registration Statement on Form S-4 (File No. 333-77049) as amended and incorporated herein by reference.

(8) Previously filed in the Company' s 2000 Annual Report filed on Form 10-K, filed April 28, 2000, and incorporated herein by reference.

(9) Previously filed in the Company' s Current Report on Form 8-K, filed July 2, 2001, and incorporated herein by reference.

(10) Previously filed in the Company' s Registration Statement on Form S-8 (File No. 333-73562), filed November 16, 2001, and incorporated herein by reference.

(11) Previously filed in the Company' s Registration Statement on Form S-8 (File No. 333-57362), filed March 21, 2001, and incorporated herein by reference.

(12) Previously filed in the Company' s Amendment No. 4 to its Registration Statement on Form S-3 (File No. 333-60284), filed July 27, 2001, and incorporated herein by reference.

(13) Previously filed in the Company' s 2001 Annual Report filed on Form 10-K, filed May 1, 2001, and incorporated herein by reference.

(14) Previously filed in the Company’ s 2002 Annual Report on Form 10-K, filed May 1, 2002, and incorporated herein by reference.

(15) Previously filed in the Company’ s Quarterly Report for the period ended July 31, 2002, filed September 16, 2002, and incorporated herein by reference.

(16) Previously filed in the Company’ s Quarterly Report for the period ended October 31, 2002, filed December 16, 2002, and incorporated herein by reference.

(17) Previously filed in the Company’ s 2003 Annual Report on Form 10-K filed May 1, 2003, and incorporated herein by reference.

(18) Previously filed in the Company’ s Quarterly Report for the period ended July 31, 2003, filed September 15, 2003, and incorporated herein by reference.

(19) Previously filed in the Company’ s Quarterly Report for the period ended October 31, 2003, filed December 15, 2003, and incorporated herein by reference.

(20) Previously filed in the Company’ s 2004 Annual Report on Form 10-K filed April 30, 2004, and incorporated herein by reference.

(21) Previously filed in the Company’ s Quarterly Report for the period ended April 30, 2004, filed June 14, 2004, and incorporated herein by reference.

(22) Previously filed in the Company’ s Quarterly Report for the period ended October 31, 2004, filed December 15, 2004, and incorporated herein by reference.

(23) Confidential treatment has been requested with respect to the omitted portions of this Exhibit, which portions have been filed separately with the Securities and Exchange Commission.

Confidential treatment has been requested for portions of this document. This copy of the document filed as an Exhibit omits the confidential information subject to the confidentiality request. Omissions are designated by three asterisks (***). A complete version of this document has been filed separately with the Securities and Exchange Commission.

EXHIBIT 10.86

Memorandum of Understanding

This Memorandum of Understanding (this "MOU") is made and entered into as of February 1, 2005 by and between Kyocera Mita Corporation, a Japanese corporation, having its principal place of business at 2-28, 1-chome, Tamatsukuri, Chuo-ku, Osaka 540-8585, Japan ("KMC") and Peerless Systems Corporation, a Delaware corporation, having its principal place of business at 2381 Rosecrans Avenue, El Segundo, CA 90245 ("Peerless").

WHEREAS, each of KMC and Peerless desire to enter into a three (3) year understanding wherein Peerless will assist KMC in developing certain high speed controllers and controller technologies;

WHEREAS, as compensation for Peerless assisting in such development, KMC intends to pay to Peerless at least eight million dollars ($8,000,000) per annum in accordance with the terms and conditions set forth herein.

For the purpose of forming this business alliance between KMC and Peerless, KMC and Peerless agree as follows:

1 <u>Consignment of Development</u>

1.1 KMC will retain Peerless and Peerless accepts such retention for the development of new products under the terms and conditions set forth in this MOU ("Development"). The immediate target products which are expected to be developed during the initial three (3) year term of this MOU ("Immediate Products") are as follows:

(1) ***;

(2) ***; and

(3) ***.

1.2 Other target products to be developed by Peerless during the term of the Development (including initial term of three (3) years) shall be separately agreed upon in writing by the parties. Immediate Products and other target products to be agreed by the parties in accordance with this Section 1.2 are collectively referred to hereinafter as the "Target Products".

1.3 KMC and Peerless agree to discuss in good faith to fix the specifications, statement of work, deliverables, schedule and other details of the Development, and to execute an individual agreement for each Target Product ("Individual Agreement"), a Sublicense Agreement covering additional terms and conditions associated with the distribution of any third party software sublicensed by Peerless (including but not limited to Adobe PostScript® and Novell NetWare®) ("Third Party Software"), and a Licensed Software Addendum ("LSA") to the Master Technology License Agreement dated April 1, 1997 and Addenda thereto entered into by and between KMC and Peerless for licenses to be granted by Peerless to KMC covering the licensing of the Peerless deliverables that will be developed under the Development (collectively, the "Agreements"). No licenses are granted by Peerless to KMC in this MOU. This MOU does not constitute a license to distribute any Peerless products or any derivative works thereof alone or in a KMC product.

1.4 Except as referenced in the licensing and distribution restrictions provided in Section 7.4 of this MOU and/or other Agreements related to Section 7.4 which follow this MOU,

Confidential treatment has been requested for portions of this document. This copy of the document filed as an Exhibit omits the confidential information subject to the confidentiality request. Omissions are designated by three asterisks (***). A complete version of this document has been filed separately with the Securities and Exchange Commission.

Peerless' relationship contemplated under this MOU for the Development is non-exclusive and Peerless reserves the right to continue its sales, marketing, licensing, and/or engineering services operations for other parties.

2 <u>Keeping Engineers by Peerless</u>

2.1 During the term of the Development, Peerless shall have *** of its fully-experienced engineers available for engagement in the Development.

3 <u>Delivery</u>

3.1 During the course of the Development, Peerless shall submit a monthly progress report to KMC.

3.2 Peerless shall make and deliver deliverables as set forth in each Individual Agreement ("Deliverables") in accordance with the schedule set forth in each Individual Agreement ("Schedule").

3.3 If any Deliverables include software programs and co-developed ASIC code, such software programs and co-developed ASIC code shall be delivered to KMC in source code form with any related documentation. This requirement applies only to software programs developed and owned by Peerless and not to any third party software that may be delivered to KMC.

3.4 If the Development under this MOU or the Agreements ceases for any reason, Peerless shall, at KMC's written request, deliver to KMC any Deliverables, whether complete or incomplete, as of the termination or expiration, provided that (i) KMC has paid to Peerless through the date of termination or expiration for any amounts owed under Section 4.1(1), (ii) KMC and Peerless have entered into one or more LSAs covering the licensing of the Deliverables and which provide for the payment of royalties with respect to such Deliverables, and (iii) KMC is not in breach or default of the MOU or any of the Agreements. Section 3.3 shall also apply to this Section 3.4.

4 <u>Consideration</u>

4.1 In accordance with the terms and conditions set out in the MOU, KMC shall pay Peerless in accordance with the following terms and conditions:

(1) An aggregate of twenty-four million dollars (US $24,000,000) to be paid over the three year term of the Development as follows: eight million dollars (US$8,000,000) per annum as a development and retention fee ("Development Fee") on a fiscal quarterly basis (the last business day of each April, July, October and January) (the "Payment Due Date") during the initial three-year term of the Development with the initial quarterly payment of two million dollars to be paid no later than April 29, 2005. When the scope of the Development is defined and the number of hours required for the Development is expected to *** hours per fiscal quarter by ***, then Peerless shall notify KMC thereof beforehand and both parties discuss the solutions such as (i) reconsidering the Schedule, (ii) increase of the number of KMC's engineers dispatched, and/or (iii) increase of the number of Peerless engineers assigned for the Development. When both parties decide to increase the number of hours, KMC shall pay Peerless, in addition to the Development Fee, at a rate of ***. In any event, Peerless shall not charge KMC for the increased Peerless engineers without prior approval of KMC.

(2) During the initial three year period of the Development, *** will be paid as an incentive bonus on a fiscal quarter basis on condition that Peerless completes mutually agreed upon objectives in a timely manner as set forth in the Schedule.

(i) If Peerless fails to meet the mutually agreed upon objectives in a timely manner of the Schedule due to causes attributable to Peerless, this incentive bonus will not be paid.

(ii) If Peerless fails to meet the mutually agreed upon objectives in a timely manner of the Schedule due to causes attributable to KMC, this incentive bonus shall be paid by KMC.

(iii) If during any specific fiscal quarter all or any part of the incentive bonus is not paid to Peerless by KMC, such amount will be withheld from incentive bonus and will not be carried over. All incentive bonus payments shall be non-refundable upon payment.

(3) Payments made by KMC to Peerless are non-transferable or non-creditable to other arrangements that may exist between the parties and are non-refundable upon payment.

5 <u>Maintenance Service</u>

5.1 As long as KMC is paying Peerless the Development Fee as defined in Section 4.1 (1) herein in accordance with the terms and conditions set forth in this MOU and/or Agreements, Peerless shall provide at no charge bug fix and error correction and response to technical inquiry for each Target Product using Deliverables prior to KMC' s acceptance date of the final Deliverable.

5.2 The Development Fee described in Section 4.1(1) includes the fee for maintenance service to be performed by Peerless during the course of one (1) year from the acceptance date of final Deliverable of each Target Product, provided, however, that the terms and conditions which will apply to such maintenance will be separately agreed upon in writing by the parties.

6 *

7 <u>Ownership and Restriction of IPR</u>

7.1 Nothing in this MOU transfers ownership of any pre-existing intellectual property from one party to the other. Any improvements, modifications, or revisions of any pre-existing intellectual property, or any other form in which such pre-existing intellectual property may be recast, transformed, or adapted, shall remain the sole property of the owner of the pre-existing intellectual property ("Derivative IP").

7.2 Any intellectual property used during the Development of any Target Product or licensed to KMC that is owned by a third party shall remain the property of such third party.

7.3 Any intellectual property (including, but not limited to software program, property that is protected by patents or copyrights, know-how, and other proprietary information) developed or created during the course of the Development ("IP") shall be owned in accordance with as follows:

(1) IP jointly developed by KMC and Peerless will be jointly and equally owned by KMC and Peerless. Either party, subject to the conditions of 7.4, will have the right to exploit such jointly developed IP without accounting or incurring any other obligation to the other party.

(2) IP independently developed by either party without reference to other party' s technical information will be solely owned by the party who develops or acquires such intellectual property rights.

(3) Notwithstanding any of the foregoing, any Third Party Software shall remain the property of such third party.

(4) Derivative IP of Peerless IP is Peerless property.

Confidential treatment has been requested for portions of this document. This copy of the document filed as an Exhibit omits the confidential information subject to the confidentiality request. Omissions are designated by three asterisks (***). A complete version of this document has been filed separately with the Securities and Exchange Commission.

(5) Derivative IP of KMC IP is KMC property.

(6) Derivative IP of jointly developed IP shall be subject to Sections 7.3(1) and 7.4.

7.4 Even if Peerless has joint ownership of IP, for a period of ***, whichever comes first, Peerless agrees not to

(a) grant any third party a license of the jointly developed IP which is incorporated into such Target Product; and

(b) distribute any deliverables and/or products covering jointly developed IP which is incorporated into such Target Product in any form (e.g. SDK, components) to any third party.

8 <u>Term</u>

8.1 The term of MOU and the Development shall be for three years, from February 1, 2005 to January 31, 2008, and thereafter shall be automatically extended for additional consecutive periods of one year each, unless either party shall have otherwise notified the other party in writing at least three (3) months prior to the expiration of the Development or any extension thereof. For the avoidance of doubt, each party agrees that this MOU is effective from the date specified in the preamble and shall continue to apply to the Development so long as the MOU is in effect.

8.2 Notwithstanding Section 8.1, Peerless and KMC may terminate without any liability of terminating party, except as provided in Section 8.3, this MOU and all or any part of the Development in the event of the other party' s Default under this MOU or the Agreements. A "Default" shall be deemed to occur in accordance with as follows:

(1) With respect to KMC

(a) KMC' s failure to pay any amounts owed within thirty (30) calendar days of the date due: or

(b) KMC materially breaches any of its obligations under this MOU and/or Agreements, which breach continues uncured for a period of thirty (30) calendar days after written notice.

(2) With respect to Peerless

(a) Peerless materially breaches any of its obligations under this MOU and/or Agreements, which breach continues uncured for a period of thirty (30) calendar days after written notice,

(b) Peerless becomes insolvent, bankrupt, or makes a general assignment for the benefit of creditors, or goes into liquidation or receivership; or

(c) Peerless ceases or takes action to cease to carry on its Turn-Key business or disposes of the whole of its assets or any substantial part of its assets that are necessary for Peerless to perform its obligations hereunder.

8.3 Any amounts unpaid as of the termination or expiration date shall be paid by KMC to Peerless within ten (10) business days after the termination or expiration date. Such amounts shall be prorated amounts from the prior Payment Due Date up to the date of termination or expiration. Notwithstanding any other provision in this MOU to the contrary, Sections 3.4, 4.1(3), 5.2, 7, 8.2, 8.3, 8.5, 10.3, 10.4, 10.6, 10.7, 10.9, 10.10, and 10.12 shall survive any termination or expiration hereof.

8.4 In the event that KMC' s competitor (***)(a "Competitor") becomes a majority stockholder of Peerless, KMC' s sole remedy for such an event shall be the termination of this MOU or the continuation of the Development under this MOU.

8.5 In case that this MOU and the Development are terminated for any reason other than Peerless being in Default under Section 8.2(2) during the initial three (3) year term of the MOU, KMC shall be obligated to pay liquidated damages to Peerless in an amount of ***. This liquidated damages provision shall not be imposed upon KMC if the reason of termination by KMC is Peerless' Default as set forth in Section 8.2(2) or if the termination has occurred after the initial three (3) year term of the MOU.

9 <u>Dispatch of KMC's Engineers</u>

9.1 KMC may request and Peerless will agree to provide facilities for 5-10 engineers designated and/or dispatched by KMC at Peerless' El Segundo, California offices for the purpose of cooperating with and supporting Peerless relating to the Development activities. When the scope of the Development is defined and it is decided by both parties that the number of KMC engineers dispatched is to be increased in accordance with Section 4.1, KMC may dispatch its additional engineers.

10 <u>Others</u>

10.1 ***.

10.2 ***.

10.3 Excluding all third party source code, Peerless will execute an escrow agreement with KMC promptly after the execution of this MOU and deliver to an escrow agent quarterly a sealed package containing Peerless' source code software programs to be developed during the course of this MOU to allow KMC to have access to such source code in case of changing the control of management of Peerless by any reason described in Section 10.2 or in case of bankruptcy of Peerless for the purpose of exercising its rights as licensee under any applicable license then in force. All costs associated with the maintenance of this escrow shall be borne solely by KMC. In the event that KMC does not maintain the escrow, or in the event of the termination of this MOU, all materials in escrow shall be immediately returned to Peerless, provided, however, that in case of termination of MOU by KMC on the ground of any reason specified in Section 8.2(2), no materials then in escrow will be released and KMC may access to the source code and continue to use the source code under any applicable license then in force.

10.4 Neither party shall disclose the content or existence of this MOU to any third party, except to the directors, employees, advisers, consultants or shareholders of each party who are bound to keep such information confidential, without prior written consent of the other party, provided, however, that KMC shall not unreasonably withhold the consent relating to announcing by Peerless to the investment community the broad nature (turnkey development of high performance color controllers) of this arrangement, including, but not limited to statements that Peerless will provide development service to KMC for Immediate Products or Target Products and the potential revenues associated with this MOU. Notwithstanding the foregoing, each party may disclose the content or existence of this MOU pursuant to governmental or judicial order requirement (including requirement by "Securities and Exchange Commission"), provided, however, that such disclosing party shall provide prompt prior written notice thereof to other party to enable it to seek a protective order or otherwise prevent or contest such disclosure or, in the case of any filings with the Securities and Exchange Commission, file a Confidential Treatment Request.

10.5 KMC and Peerless shall in good faith exert their best efforts to execute the Agreements as soon as possible.

10.6 In the event any dispute, controversy, or difference, whether based on tort, contract, or legal theory (including but not limited to a claim of fraud or misrepresentation) arises between the parties out of or in relation to or in connection with this MOU (a "Dispute"), the parties hereto agree as follows

(1) In the first instance do their utmost to settle the Dispute.

(2) If the Dispute is solely related to the payment of money owed to Peerless by KMC, Peerless shall have the option to seek to resolve such Dispute either by arbitration in accordance with Section 10.6(3) or in any federal or state court located in Los Angeles, California, USA. If the Dispute is solely related to the payment of money owed to KMC by Peerless, KMC shall have the option to seek to resolve such Dispute either by arbitration in accordance with Section 10.6(3) or in any federal or state court located in Los Angeles, California, USA. Each party hereby waives the right to a jury trial. In any proceeding under this Section 10.6(2), neither party shall be entitled to an award of punitive or exemplary damages.

(3) If the parties fail to settle the Dispute amicably, then the Dispute shall be finally settled by arbitration under the Rules of the American Arbitration Association ("AAA"). The place of arbitration shall be Los Angeles, California, USA. The arbitration shall be held before a single arbitrator who is knowledgeable in the embedded software industry. The arbitration shall be conducted in English. The arbitrator shall not have the power to award punitive or exemplary damages. The prevailing party shall be entitled to an award of its attorneys fees associated with the arbitration and any other costs and expenses of the arbitration shall be borne as provided by the rules of the AAA. The arbitrator's decision and any award rendered shall be final and binding upon the parties. Each party hereby waives the right to a jury trial.

(4) The following disputes shall not be subject to arbitration and shall instead be brought in any federal or state court located in Los Angeles, California, USA: (a) any dispute involving infringement of, ownership or title to a party's intellectual property; (b) any dispute involving enforcement of the confidentiality provisions set forth in this MOU or any applicable confidentiality agreement; or (c) any judicial proceeding in equity seeking temporary restraining orders, preliminary injunctions or other interlocutory relief. Disputes relating to Third Party Software shall be resolved in accordance with any applicable requirements specified by the owners or principal licensors of such Third Party Software. Each party hereby waives the right to a jury trial.

10.7 Except for the Master Technology License Agreement dated April 1, 1997 ("MTLA"), the License Software Addendum #4 (as amended) dated January 15, 2004 to the MTLA, the License Software Addendum #5 dated February 17, 2004 to the MTLA, and the Non-Disclosure Agreement dated September 13, 2004, this MOU and the Non-Disclosure Agreement entered into on February 21, 2005 and made effective as of November 10, 2004 constitute the binding and entire agreement relating to the subject matter of this MOU and supersedes all previous agreements relating to the subject matter of this MOU, either oral or written, between the parties, provided, however, that this MOU takes effect only after this MOU passes the resolution of both parties' board meeting.

10.8 Nothing contained herein shall be deemed to create a joint venture or partnership or agency relationship between KMC and Peerless. Neither party shall have the right or authority to, and each party shall not, assume or create any obligation or responsibility, express or implied, on behalf of or in the name of the other party or bind the other party in any manner. Nothing set forth herein shall be deemed to confer upon any person or entity other than the parties hereto a right of action either under this MOU or any manner whatsoever.

10.9 Neither party may sell, transfer or assign this MOU without the prior written consent of the other party. This MOU shall be binding upon and inure to the benefit of each party, its successors or assignees.

10.10 This MOU shall be governed by and construed in accordance with the laws of the United States of America and the State of California.

10.11 This MOU is the result of arm' s length negotiations between the parties and shall be construed to have been drafted by all parties such that any ambiguities in this MOU shall not be construed against either party.

10.12 KMC hereby agrees that, for a period of six (6) months after termination of the MOU, neither KMC nor any person acting on behalf of or in concert with KMC will, without the prior written consent of Peerless, directly or indirectly, solicit to employ, or actually employ, any of the executive officers or key employees of Peerless (i) with whom KMC or any person acting on behalf of or in concert with KMC have had contact during the Development or (ii) who were specifically identified to KMC by Peerless or any person acting on behalf of or in concert with KMC during the Development; provided, however, that KMC may engage in general solicitations for employees in the ordinary course of business and consistent with past practice, and (ii) KMC may directly or indirectly solicit to employ and actually employ any executive officers and/or employees who have been terminated or laid off or who have voluntary resigned from employment and the resignation occurred more than six (6) months before or who seek employment by responding to KMC' s general solicitations.

10.13 Prior to either party' s disclosure of any of its confidential information to the other in connection with the Development, the parties shall enter into a mutually agreeable confidentiality agreement.

In Witness Whereof, the parties hereto have caused this Memorandum of Understanding to be executed by their respective authorized representative as of the date first above written.

Kyocera Mita Corporation		Peerless Systems Corporation	
By:	/s/ TETSUO OKADA	By:	/s/ HOWARD J. NELLOR
Name:	Tetsuo Okada	Name:	Howard J. Nellor
Title:	President	Title:	CEO and President

Confidential treatment has been requested for portions of this document. This copy of the document filed as an Exhibit omits the confidential information subject to the confidentiality request. Omissions are designated by three asterisks (***). A complete version of this document has been filed separately with the Securities and Exchange Commission.

EXHIBIT 10.87

AMENDMENT NO. 21
TO THE
POSTSCRIPT SOFTWARE DEVELOPMENT LICENSE
AND SUBLICENSE AGREEMENT
BETWEEN
ADOBE SYSTEMS INCORPORATED
AND
PEERLESS SYSTEMS CORPORATION
Effective Date: January 1, 2005

This Amendment No. 21 (the "Amendment") to the PostScript Software Development License and Sublicense Agreement dated July 23, 1999 (the "Agreement") is between Adobe Systems Incorporated, a Delaware corporation having a place of business at 345 Park Avenue, San Jose, CA 95110 ("Adobe") and Peerless Systems Corporation, a Delaware corporation, having a place of business at 2381 Rosecrans Avenue, El Segundo, California 90245 ("Peerless").

WHEREAS, the purpose of this Amendment is to establish and revise certain royalty terms as set forth in this Amendment.

NOW, THEREFORE, the parties agree as follows:

1. The following new *Paragraph 1(c)* is hereby added to **EXHIBIT D-1** (Non-Roman Font Programs):

"(c) **Kozuka Mincho and Kozuka Gothic Font Programs for Japanese Typefaces**: Adobe will provide the Kozuka Mincho Pro-Regular Typeface that supports the Adobe-Japan1-4 character collection and Kozuka Gothic Pro-Medium Typeface that supports the Adobe-Japan1-4 character collection as defined in Adobe' s Technical Note #5078 ("Adobe-Japan1-2 Character Collection for CID-Keyed Fonts"). Generic characters listed therein are not typeface specific. Special character set or encodings are not provided.

Identifying Trademark	Character Collection	Trademarks Owner
Kozuka Mincho Pro-Regular	Adobe-Japan1-4	Adobe Systems Incorporated
Kozuka Gothic Pro-Medium	Adobe-Japan1-4	Adobe Systems Incorporated

Confidential treatment has been requested for portions of this document. This copy of the document filed as an Exhibit omits the confidential information subject to the confidentiality request. Omissions are designated by three asterisks (***). A complete version of this document has been filed separately with the Securities and Exchange Commission.

2. TABLE A in *Paragraph 3.2.1* of **EXHIBIT O** (Royalty Payments and Other Fees) is hereby deleted and replaced with the following:

***

3. The following new *Paragraph 9.1.5* is hereby added to **EXHIBIT O** (Royalty Payments and Other Fees):

> "9.1.5 The Kozuka Mincho Pro-Regular and/or Kozuka Gothic Pro-Medium Font Programs for Japanese Typefaces may be distributed with Licensed Systems or distributed bundled with the Revised Object when distributed as an upgrade for a previously distributed Licensed System, at the royalty rate of *** for each copy of each such Font Program.

4. TABLE K in *Paragraph 3.2.3* of **EXHIBIT O** (Royalty Payments and Other Fees) is hereby deleted and replaced with the following:

***

5. The first table in **EXHIBIT O-1** (Royalty Payments and Other Fees for Royalty-Bearing Components of Peerless-Branded Licensed Systems) is hereby deleted and replaced with the following:

***

6. All other terms and conditions of the Agreement shall remain in full force and effect.

IN WITNESS WHEREOF, each of Adobe and Peerless has executed this Amendment No. 21 to the PostScript Software Development License and Sublicense Agreement by its duly authorized representative.

Adobe:

ADOBE SYSTEMS INCORPORATED

By: /s/ JEFF RUSSAKOW

Print Name: Jeff Russakow

Title: VP, WW Sales Operations & Customer Support

Date: 3/30/05

Peerless:

PEERLESS SYSTEMS CORPORATION

By: /s/ WILLIAM NEIL

Print Name: William Neil

Title: VP Finance, CFO

Date: March 17, 2005

CONFIDENTIAL

CONFIDENTIAL SEPARATION AGREEMENT AND MUTUAL RELEASE

THIS CONFIDENTIAL SEPARATION AGREEMENT AND MUTUAL RELEASE (“Agreement”) is entered into as of this 4th day of June 2004, (“Date of this Agreement”) by and between Peerless Systems Corporation (the “Company”), on the one hand, and Denis W. Retoske (the “Executive”), on the other hand.

WHEREAS, the employment relationship between the Company and Executive is being terminated;

WHEREAS, Executive and the Company desire to specify the terms of the separation. For and in consideration of the foregoing recitals and the mutual covenants and agreements set forth herein, the Company and the Executive agree as follows:

1. Employment Status. Executive hereby resigns from all positions as an employee and officer of the Company and any affiliates effective June 4, 2004, (the “Resignation Date”). Executive has received all compensation earned through the Resignation Date, including without limitation, any accrued, unused vacation pay. Executive understands that he will not be entitled to any compensation or benefits of employment beyond the Resignation Date, except as set forth below. Executive further understands that he is giving up all rights and benefits of employment with the Company except as set forth below.

2. Return of Company Property. Executive will return to the Company, all files, records, reports, data, correspondence, memoranda and other documents (including handwritten notes regarding, and drafts of same), equipment, pager, keys and all other physical, intellectual or personal property which Executive received from the Company and which are the property of the Company on or before the Resignation Date. Executive shall be entitled to retain his laptop computer and his office chair until the completion of consulting support to the Board of Directors, or as otherwise determined.

3. Severance Payments to Executive. In consideration of the release of all claims, the Company agrees to pay the Executive (“the Payments”) wages equal to his regular base pay of $157,500.00 for a period of six (6) months beginning June 7, 2004 and ending December 7, 2004 in approximately equal installments over that period, less withholding required by law and/or elected by Executive.

The Payments hereunder be made in accordance with the Company’ s payroll schedule; provided however, that the first payment hereunder shall be made on the first regular pay date that falls not less than eight (8) days after Executive’ s execution of the Agreement, provided that Executive does not revoke it in accordance with its terms. In the event that one or more pay dates have passed between June 7, 2004 and the date on which the first payment is due, the first payment shall include payment for the entire period between June 7, 2004 and the first payment. Payments shall be direct deposited to a bank account designate by the Executive and the notice of payment to the Executive shall be sent by regular mail to the Executive at 1850 Capri Circle, Costa Mesa, CA 92626, or to a further address provided to the Company by the Executive.

Except as otherwise set out herein, the Payments shall be in lieu of any other compensation or benefit, including, without limitation, any further bonus, payments arising out of the Transaction Incentive Plan, oral and/or written agreements between the Executive and Company as referenced in the 2002 Proxy and the 2003 Proxy, or other severance pay plan or policy of the Company. This represents the Company' s sole financial obligation to Executive under this Agreement.

Provided that Executive timely elects to continue his and his dependents' health care coverage in accordance with COBRA, an estimated dependent health insurance premium shall be calculated and deducted from the Payments, and shall be applied to Executive' s COBRA premium, and the Company shall pay any additional COBRA premium for Executive and his dependent' s COBRA coverage beginning July 1, 2004 and continuing through and including June 30, 2005. Thereafter, Executive shall be eligible to continue health care benefits at his own expense in accordance with COBRA.

4. Vested Stock Options. The Company agrees that the Executive' s stock options granted to the Executive prior to this June 4, 2004 and unvested as of June 4, 2004, shall and have become immediately vested to the benefit of the Executive, and in consideration of Executive' s designation by the Company during employment as a Section 16 officer, said Executive shall have until and including June 4, 2005 to exercise those employee stock options that are vested to Executive as of the Date of this Agreement.

5. Release of the Company by Executive.

a. General Release. Executive hereby releases and forever discharges the Company, its parents, subsidiaries, affiliates, predecessors, successors and each of it their associates, owners, stockholders, members, assigns, employees, agents, directors, officers, partners, representatives, lawyers, donors or contributors and all persons acting by, through, under, or in concert with them, or any of them, (collectively the "Releasees") of and from any and all manner of action or actions, causes or causes of action, in law or in equity, suits, debts, liens, contracts, agreements, promises, liabilities, claims, demands, damages, losses, costs or expenses, of any nature whatsoever, known or unknown, fixed or contingent (hereinafter called "Claims"), which they now have or may hereafter have against the Releasees by reason of any and all acts, omissions, events or facts occurring or existing prior to the date hereof, except as expressly provided herein. The Claims released hereunder include, without limitation, any alleged breach of any employment agreement; any alleged breach of any covenant of good faith and fair dealing, express or implied; any alleged torts or other alleged legal restrictions relating to the Executive' s employment and the termination thereof; and any alleged violation of any federal, state or local statute or ordinance including, without limitation, Title VII of the Civil Rights Act of 1964, as amended, the Federal Age Discrimination in Employment Act, the Americans With Disabilities Act, and any state or local laws of similar effect. This Release shall not apply to Executive 's right to receive the benefits provided for in the Agreement, or to retirement and/or employee welfare benefits, if any, that have vested and accrued prior to his separation from employment with the Company.

EXECUTIVE ACKNOWLEDGES THAT EXECUTIVE IS FAMILIAR WITH THE PROVISIONS OF CALIFORNIA CIVIL CODE SECTION 1542, WHICH PROVIDES AS FOLLOWS:

> **"A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH, IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR."**

EXECUTIVE BEING AWARE OF SAID CODE SECTION, HEREBY EXPRESSLY WAIVES ANY RIGHTS EXECUTIVE MAY HAVE THEREUNDER, AS WELL AS UNDER ANY OTHER STATUTES OR COMMON LAW PRINCIPLES OF SIMILAR EFFECT.

b. Release of Age Discrimination Claims. Executive agrees and expressly acknowledges that this Agreement includes a waiver and release of all claims which Executive has or may have under the Age Discrimination in Employment Act of 1967, as amended, 29 U.S.C. § 621, et seq. ("ADEA"). Executive understands and agrees that:

(1) This paragraph, this release and this Agreement are written in a manner calculated to be understood by Executive.

(2) The waiver and release of claims under the ADEA contained in this Agreement does not cover rights or claims that may arise after the date on which Executive signs this Agreement.

(3) This Agreement provides for consideration in addition to anything of value to which Executive is already entitled.

(4) Executive is advised to consult an attorney before signing this Agreement.

(5) Executive is granted twenty-one (21) days after Executive is presented with this Agreement to decide whether or not to sign this Agreement. If Executive executes this Agreement prior to the expiration of such period, Executive does so voluntarily and after having had the opportunity to consult with an attorney, and waives the remainder of the twenty-one (21) day period.

(6) Executive will have the right to revoke this Agreement under the ADEA within seven (7) days of signing this Agreement.

c. Manner of Revocation. In the event that Executive elects to revoke this Agreement, he shall deliver within the time period prescribed above to Howard J. Nellor a writing stating that he is revoking this Agreement and subscribed by the Executive.

d. Consequences of Revocation. In the event that Executive should elect to revoke this Agreement as described in the paragraph above, this Agreement shall be null and void in its entirety.

e. No Assignment of Claims. Executive represents and warrants to the Releasees that there has been no assignment or other transfer of any interest in any Claim which Executive may have against the Releasees, or any of them, and Executive agrees to indemnify and hold the Releasees harmless from any liability, claims, demands, damages, costs, expenses and attorneys' fees incurred as a result of any person asserting any such assignment or transfer of any rights or Claims under any such assignment or transfer from such Party.

f. No Suits or Actions. Executive agrees that if he hereafter commences, joins in, or in any manner seeks relief through any suit arising out of, based upon, or relating to any of the Claims released hereunder or in any manner asserts against the Releasees any of the Claims released hereunder, then he will pay to the Releasees against whom such claim(s) is asserted, in addition to any other damages caused thereby, all attorneys' fees incurred by such Releasees in defending or otherwise responding to said suit or Claim. Provided, however, that this subsection (f) shall not apply to any challenge to the release under the Older

Workers Benefit Protection Act, or claim under the Federal Age Discrimination in Employment Act.

g. No Admission. The Parties further understand and agree that neither the payment of money nor the execution of this Release shall constitute or be construed as an admission of any liability whatsoever by the Releasees.

6. Release of the Executive by Company.

a. General Release. Company hereby releases and forever discharges the Executive of and from any and all manner of action or actions, causes or causes of action, in law or in equity, suits, debts, liens, contracts, agreements, promises, liabilities, claims, demands, damages, losses, costs or expenses, of any nature whatsoever, known or unknown, fixed or contingent (hereinafter called "Claims"), which they now have or may hereafter have against the Executive by reason of any and all acts, omissions, events or facts occurring or existing prior to the date hereof, except as expressly provided herein. The Claims released hereunder include, without limitation, any alleged breach of any employment agreement; any alleged breach of any covenant of good faith and fair dealing, express or implied; and any other alleged legal matters relating to the Executive' s employment and the termination thereof; and any alleged violation of any federal, state or local statute or ordinance.

b. Indemnification. The Executive shall have the benefit of indemnification by the Company to the fullest extent permitted by applicable law, which indemnification shall continue after the execution of this Agreement for such period as may be necessary to continue to indemnify Executive for his acts during his employment to the fullest extent permitted by applicable law.

7. Non-Disparagement. The Company and the Executive each agrees to refrain from any disparagement, false light, defamation, slander of the other, or tortious interference with the contracts and relationships of the other.

8. Intellectual Property. Confidential Information and Trade secrets/Nonsolicitation. Executive acknowledges that the provisions of any agreements he has entered with the Company concerning the assignment of any rights to intellectual property, the solicitation of customers and/or employees, and/or nondisclosure of the confidential information of the Company, its customers, business partners, parents, subsidiaries and affiliates remain in full force and effect and are not modified or superseded by this Agreement. Copies of Executive' s agreements concerning intellectual property, confidential information and solicitation of customers and employees are attached hereto as Exhibit "A".

9. Confidentiality of Terms. Executive expressly acknowledges that this Agreement and all matters relating to or leading up to the negotiation and effectuation of this Agreement, are confidential and shall be accorded the utmost confidentiality and shall not be disclosed to any third party except to Executive' s spouse, his legal, actuarial, pension, accounting and tax advisors to the extent necessary to perform services or as required by law, rule or regulation. In addition, Executive may disclose the provisions of paragraph 7 to any prospective employer. Executive agrees that if any disclosure is made as permitted under this paragraph, then such persons or entities shall be cautioned about the confidentiality obligations imposed by this Agreement and required to abide by the terms of this confidential undertaking.

10. Further Services. Executive and Company agree that, solely at the discretion of the Company, the Company may engage Executive as a Consultant for services within his professional areas of expertise, which services do not arise out of this Agreement and are completely independent of this Agreement, at compensation to be agreed upon by the parties.

11. Advice of Counsel. Executive represents and warrants that he has read this Agreement, that he has had adequate time to consider it, that he had been advised by the Company to consult with an attorney and has had the opportunity to consult with an attorney prior to executing this Agreement. Executive understands the meaning and application of this Agreement and he has signed this Agreement knowingly, voluntarily and of his own free will with the intent of being bound by it.

12. Severability: Modification of Agreement. If any provision of this Agreement shall be found invalid or unenforceable in whole or in part, then such provisions shall be deemed to be modified or restricted to the extent and in the manner necessary to render the same valid and enforceable or shall be deemed excised from this Agreement as such circumstances may require, and this Agreement shall be construed and enforced to the maximum extent permitted by law as if such provision had been originally incorporated herein as so modified or restricted or as if such provision had not been originally incorporated herein, as the case may be.

13. Arbitration; Waiver of Jury Trial. Except for claims for emergency equitable or injunctive relief which cannot be timely addressed through arbitration, the parties hereby agree to submit any claim or dispute arising out of the terms of this Agreement (including exhibits) and/or any dispute arising out of or relating to Executive' s employment with the Company in any way, to private and confidential arbitration by a single neutral arbitrator through the American Arbitration Association ("AAA"). Subject to the terms of this paragraph, the arbitration proceedings shall be governed by the then current AAA rules governing employment disputes, and shall take place in

Orange County, California, provided, however, that this Agreement shall be interpreted to comply with applicable law if there is any conflict between applicable law and such rules that would otherwise render this agreement to arbitrate invalid. The decision of the arbitrator shall be final and binding on all parties to this Agreement, rendered in writing, and judgment thereon may be entered in any court having jurisdiction. Except if otherwise required by applicable law, the party initiating arbitration shall advance the arbitrator' s fee; however, all costs of the arbitration proceeding or litigation to enforce this Agreement, including attorneys' fees and witness expenses, shall be paid as the arbitrator or court order in accordance with applicable law. Except for claims for emergency equitable or injunctive relief that cannot be timely addressed through arbitration, this arbitration procedure is intended to be the exclusive method of resolving any claim relating to the obligations set forth in this Agreement. The Parties understand and agree that they are waiving their right to a jury trial as to any claim subject to this provision.

14. Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of and be enforceable by the parties hereto and their respective successors and assigns. Notwithstanding the foregoing, neither this Agreement nor any rights hereunder may be assigned to any party by the Company or Executive without the prior written consent of the other party hereto, which shall not be unreasonably withheld.

15. Litigation by Others. Executive agrees to cooperate with the Company and its agents and attorneys in the event that Executive is called as a witness under subpoena or otherwise in any litigation, government investigation or other proceeding involving the Company; provided, however, that the Company shall pay for Executive' s reasonable and actual costs and expenses (including lost wages) incurred in connection with such participation. Executive agrees not to aid in, assist in, or encourage the pursuit of, litigation against the Company by any other person or entity, except as required by applicable law.

16. Entire Agreement/No Oral Modification. Executive and the Company each represent and warrant that this Agreement is the entire agreement between the parties with respect to the subject matter herein, and that no promise or inducement has been offered, made or relied upon, except as set forth herein and that the consideration stated herein is the sole consideration for this Agreement. This Agreement does not modify or supersede the provisions of any agreements Executive has entered with the Company concerning the assignment of any rights to intellectual property, solicitation of customers and/or employees, nondisclosure of the confidential information of the Company, its customers, business partners, parents, subsidiaries and affiliates, or governing stock options, stock grants or restricted stock owned by the Executive.

17. Warranty. The Company represents and warrants that that it has disclosed all material facts to the Executive that are relevant to the Executive' s decision, and has not omitted or failed to disclose any material fact that would cause the Executive to decline to enter into this Agreement.

18. Headings. Headings contained in this Agreement are used for convenience only, and shall not supplement or modify the terms of this Agreement.

19. Choice of Law. The parties agree that this Agreement shall be construed and enforced in accordance with the laws of the State of California.

Executive

/s/ Denis W. Retoske

Denis W. Retoske

Date: June 4, 2004

Peerless Systems

/w/ Howard J. Nellor

Howard J. Nellor

Title: President & CEO

Date: June 4, 2004

EXHIBIT 10.89

PEERLESS/CONSULTANT CONSULTING AGREEMENT

This CONSULTING AGREEMENT (this "Agreement"), made and entered into this June 4, 2004 ("Effective Date"), by and between Peerless Systems Corporation, a Delaware corporation, having a principal place of business at 2381 Rosecrans Avenue, El Segundo, CA 90245 (hereinafter "Peerless"), and Denis W. Retoske, Sr., Attorney-at-Law, A Professional Law Corporation (EIN 72-1572825) 1850 Capri Circle, Costa Mesa, CA 92626(hereinafter "CONSULTANT").

WITNESSETH:

WHEREAS, CONSULTANT represents that it has expertise in the area of the law and is ready, willing, and able to provide consulting assistance to Peerless on the terms and conditions set forth herein; and

WHEREAS, Peerless, in reliance on CONSULTANT' s representations, is willing to engage CONSULTANT as an independent contractor, and not as an employee, on the terms and conditions set forth herein;

NOW, THEREFORE, in consideration of the obligations herein made and undertaken, the parties, intending to be legally bound, covenant and agree as follows:

Section 1 - SCOPE OF SERVICES

1.1 CONSULTANT shall provide consulting services in the area of legal services as to certain corporate matters as directed by the CEO, the CFO or members of the Board. Denis W. Retoske will be assigned by CONSULTANT to work with Peerless as to certain business matters. CONSULTANT shall render such services and deliver the required reports and other deliverables ("Deliverables") in accordance with the timetable and milestones set forth in Exhibit A. In the event CONSULTANT anticipates at any time that it will not reach one or more milestones or complete one or more assignments within the prescribed timetable, CONSULTANT shall immediately so inform Peerless by written notice, submit proposed revisions to the timetable and milestones that reflect CONSULTANT' s best estimates of what can realistically be achieved, and continue to work under the original timetable and milestones until otherwise directed by Peerless. CONSULTANT shall also prepare and submit such further reports of its performance and its progress as Peerless may reasonably request from time to time.

1.2 CONSULTANT shall provide and make available to Peerless such resources as shall be necessary to perform the services called for by this Agreement and the Exhibits and Addenda thereto.

1.3 Peerless shall, within fifteen (15) business days of receipts of each Deliverable submitted to Peerless, advise CONSULTANT of Peerless' acceptance or rejection of such Deliverable. Any rejection shall specify the nature and scope of the deficiencies in such Deliverable. CONSULTANT shall, upon receipt of such rejection, act diligently to correct such deficiencies. The failure of Peerless to provide such a notice of rejection within such period shall constitute acceptance by Peerless of said Deliverable.

1.4 CONSULTANT, at its own cost, agrees to provide working space and facilities, and any other services and materials CONSULTANT or its personnel may reasonably request in order to perform the work assigned to them. All work shall be performed at CONSULTANT' s facilities unless otherwise mutually agreed and shall be performed in a workmanlike and professional manner by employees of CONSULTANT having a level of skill in the area commensurate with the requirements of the scope of work to be performed. CONSULTANT shall make sure its employees at all times observe security and safety policies of Peerless.

1.5 Peerless will advise CONSULTANT of the individuals to whom CONSULTANT' s personnel will report for purposes of day-to-day work assignments. Peerless and CONSULTANT shall develop appropriate administrative procedures to apply to such personnel. Peerless shall periodically prepare an evaluation of the performance of CONSULTANT' s personnel in the performance of the duties set out herein.

1.6 The parties agree that the services of Denis W. Retoske, Sr. are essential to the satisfactory performance by CONSULTANT of the scope of work called for in this Agreement. The parties further agree that if either of such individuals leaves the employ of CONSULTANT during the term of this Agreement for any reason or is unavailable to continue full-time the work called for herein, and if substitute individuals acceptable to Peerless are not available to continue the work within five (5) days, Peerless shall have the right to terminate this Agreement pursuant to Section 2.2 hereof.

1.7 Peerless may interview the personnel CONSULTANT assigns to Peerless' work. Peerless shall have the right, at any time, to request the removal of any employee(s) of CONSULTANT whom Peerless deems to be unsatisfactory. Upon such request, CONSULTANT shall use all reasonable efforts to promptly replace such employee(s) with substitute employee(s) having appropriate skills and training.

1.8 Anything herein to the contrary notwithstanding, the parties hereby acknowledge and agree that Peerless shall have no right to control the manner, means, or method by which CONSULTANT performs the services called for by this Agreement. Rather, Peerless shall be entitled only to direct CONSULTANT with respect to the elements of services to be performed by CONSULTANT and the results to be derived by Peerless, to inform CONSULTANT as to where and when such services shall be performed, and to review and assess the performance of such services by CONSULTANT for the limited purposes of assuring that such services have been performed and confirming that such results were satisfactory.

Section 2 - TERM OF AGREEMENT

2.1 This Agreement shall commence on the date and year first above written ("Effective Date"), and unless modified by mutual agreement of the parties or terminated earlier pursuant to the terms of this Agreement, shall continue until December 31, 2005 or until sooner terminated by Peerless.

2.2 This Agreement may be terminated by Peerless upon fifteen (15) days' prior written notice, with or without cause. This Agreement may be terminated immediately by a party if the other party breaches any term hereof and the breaching party fails to cure such breach within fifteen (15) days of written notice of such breach.

2.3 Upon termination of this Agreement for any reason, CONSULTANT shall promptly return to Peerless all copies of any Peerless data, records, or materials of whatever nature or kind, including all materials incorporating the proprietary information of Peerless. CONSULTANT shall also furnish to Peerless all work in progress or portions thereof, including all incomplete work.

2.4 Within five (5) days of termination of this Agreement for any reason. CONSULTANT shall submit to Peerless an itemized invoice for any fees or expenses theretofore accrued under this Agreement. Peerless, upon payment of accrued amounts so invoiced, shall have no further liability or obligation to CONSULTANT whatsoever for any further fees, expenses, or other payment.

Section 3 - FEES, EXPENSES, AND PAYMENT

3.1 In consideration of the services to be performed by CONSULTANT, Peerless shall, within twenty (20) days of acceptance of each of the Deliverables, pay CONSULTANT the fees set forth in Exhibit A attached hereto unless otherwise mutually agreed, no further fees for continued performance of CONSULTANT shall be owing.

3.2 In addition to the foregoing, Peerless shall pay CONSULTANT its actual out-of-pocket expenses that, at Peerless' sole discretion, are reasonable and necessary for CONSULTANT to incur in furtherance of its performance hereunder. CONSULTANT agrees to provide Peerless with access to such original receipts, ledgers, and other records as may be reasonably appropriate for Peerless or its accountants to verify the amount and nature of any such expenses.

3.3 In the event CONSULTANT terminates this Agreement because of the breach of Peerless, CONSULTANT shall be entitled to a pro rata payment for work in progress based on the percentage of work then completed. No such pro rata payment shall be made if Peerless terminates this Agreement because of the breach of CONSULTANT.

3.4 CONSULTANT agrees that the fees and charges for any follow-on or additional work not covered in the scope of work described in Exhibit A shall be performed at the lesser of (1) CONSULTANT's then-current rates for such work or (2) the rates applicable to the scope of work fixed by this Agreement.

3.5 Peerless shall pay all fees and expenses owing to CONSULTANT hereunder within thirty (30) days after CONSULTANT has submitted to Peerless an itemized invoice therefor.

Section 4 - TREATMENT OF CONSULTANT PERSONNEL

4.1 Compensation of CONSULTANT' s Personnel. CONSULTANT shall bear sole responsibility for payment of compensation to its personnel. CONSULTANT shall pay and report, for all personnel assigned to Peerless' work, federal and state income tax withholding, social security taxes, and unemployment insurance applicable to such personnel as employees of CONSULTANT. CONSULTANT shall bear sole responsibility for any health or disability insurance, retirement benefits or other welfare or pension benefits (if any) to which such personnel may be entitled. CONSULTANT agrees to defend, indemnify, and hold harmless Peerless, Peerless' officers, directors, employees, and agents, and the administrators of Peerless' benefit plans from and against any claims, liabilities, or expenses relating to such compensation, tax, insurance, or benefit matters; provided that Peerless shall promptly notify CONSULTANT of each such claim when and as it comes to Peerless' attention, cooperate with CONSULTANT in the defense and resolution of such claim, and not settle or otherwise dispose of such claim without CONSULTANT' s prior written consent, such consent not to be unreasonably withheld.

4.2 Workers' Compensation. Notwithstanding any other workers' compensation or insurance policies maintained by Peerless, CONSULTANT shall procure and maintain workers' compensation coverage sufficient to meet the applicable statutory requirements of any state or other jurisdiction where CONSULTANT' s personnel assigned to Peerless' work are located.

4.3 CONSULTANT' s Agreements With Personnel. CONSULTANT shall obtain and maintain in effect written agreements with each of its personnel who participate in any of the Peerless' work hereunder. Such agreements shall contain terms sufficient for CONSULTANT to comply with all provisions of this Agreement, including but not limited to Confidential Disclosure Agreements regarding the handling, securing and use of Peerless Confidential Information.

4.4 State and Federal Taxes. As neither CONSULTANT nor its personnel are Peerless' employees, Peerless shall not take any action or provide CONSULTANT' s personnel with any benefits or commitments inconsistent with any of such undertakings by CONSULTANT. In particular:

1. Peerless will not withhold FICA (Social Security) from CONSULTANT' s payments.

2. Peerless will not make state or federal unemployment insurance contributions on behalf of CONSULTANT or its personnel.

3. Peerless will not withhold state and federal income tax from payment to CONSULTANT.

4. Peerless will not make disability insurance contributions on behalf of CONSULTANT.

5. Peerless will not obtain workers' compensation insurance on behalf of CONSULTANT or its personnel.

4.5 Waiver of Benefits - CONSULTANT herein and for its employees, for the consideration paid to it by Peerless, specifically waives all claims to or interest in any employee benefit provided to Peerless to its employees. Accordingly, CONSULTANT hereby specifically waives any right to participate in, and any claim or interest in benefits under, any employee benefit plan maintained, sponsored or offered by Peerless for the benefit of its employees even if CONSULTANT and/or any of its employees are subsequently determined (by judicial action or otherwise) to be common law employees of Peerless and otherwise eligible to participate in such employee benefit plans and receive benefits thereunder. Furthermore, I understand and agree that I am not entitled to any and all benefits under Peerless' 401(k) plan. As such, if for any reason whatsoever, I am found to be entitled to such benefits by a court or governmental agency, I expressly elect not to contribute to said 401(k) plan.

4.6 Licenses - CONSULTANT represents that he or she is the holder of the following Licenses or certificates:

1. CA Prof Corp License # 15095

2. CA 103351

3. DC 415269

Section 5 - CLIENT DISCLOSURE

5.1 CONSULTANT represents that the following is a complete and accurate list of CONSULTANT' s clients as of the Effective Date of this Agreement ("Client List"):

1. None

5.2 CONSULTANT agrees to furnish Peerless with an updated Client List during the term of this Agreement if and when there are any additions to this Client List.

Section 6 - RIGHTS IN DATA

6.1 As between Peerless and CONSULTANT and for the consideration set out herein and for other consideration which the parties acknowledge having been tendered and received, except as set forth below in this Section 6, all right, title, and interest in and to the programs, systems, data, or materials used or produced by CONSULTANT in the performance of the services called for in this Agreement shall remain or become the property of Peerless.

6.2 All right, title, and interest in and to all Deliverables, including all rights in copyrights or other intellectual property rights pertaining thereto, shall be held by Peerless. CONSULTANT shall mark all Deliverables with Peerless' copyright or other proprietary notice as directed by Peerless and shall take all actions deemed necessary by Peerless to perfect Peerless' rights therein. In the event that CONSULTANT can by law or otherwise retain any rights to any Deliverables, CONSULTANT agrees to assign, and upon creation thereof automatically assigns, all right, title, and interest in and to such Deliverables to Peerless, without further consideration. CONSULTANT agrees to execute any documents of assignment or registration of copyright or other intellectual property rights requested by Peerless respecting any and all Deliverables. CONSULTANT retains no rights or license to utilize such Deliverables except in furtherance of the purposes of this Agreement or unless specifically authorized in writing by Peerless.

6.3 All copyrights, patents, trade secrets, design rights, or other intellectual property rights associated with any ideas, designs, concepts, techniques, inventions, processes, or works of authorship developed or created by CONSULTANT or its personnel during the course of performing Peerless' work (collectively, the "Work Product") shall belong exclusively to Peerless. CONSULTANT automatically assigns, and shall cause its personnel automatically to assign, at the time of creation of the Work Product, without any requirement of further consideration, any right, title, or interest it or they may have in such Work Product, including any and all copyrights, moral rights, community property rights or other intellectual property rights pertaining thereto, and CONSULTANT agrees, and causes its personnel to agree, not to exercise any moral rights with respect to the Work Products. Upon request of Peerless, CONSULTANT shall take such further actions, and shall cause its personnel to take such further actions, including execution and delivery of instruments of conveyance, as may be appropriate to give full and proper effect to such assignment.

6.4 Notwithstanding anything to the contrary herein, CONSULTANT and its personnel shall be free to use and employ its and their general skills, know-how, and expertise, and to use, disclose, and employ any generalized ideas, designs, concepts, know-how, methods, techniques, or skills gained or learned during the course of any assignment, so long as it or they acquire and apply such information without disclosure of any confidential or proprietary information of Peerless and without any unauthorized use or disclosure of Work Product.

6.5 All right, title, and interest in and to any programs, systems, data, designs, and materials furnished to CONSULTANT by Peerless are and shall remain the property of Peerless.

6.6 All right, title, and interest in and to any programs, systems, data, designs, and materials furnished by CONSULTANT ("CONSULTANT IP"), are and shall remain the property of CONSULTANT. CONSULTANT grants to Peerless a perpetual, worldwide, and non-exclusive license to use, sell, modify and otherwise distribute "CONSULTANT IP" or copies thereof.

Section 7 - PROPRIETARY INFORMATION

7.1 Confidentiality. CONSULTANT shall maintain in strict confidence, and shall use and disclose only as authorized by Peerless, all information of a competitively sensitive or proprietary nature that it receives in connection with the work performed for Peerless pursuant to each Work Order. CONSULTANT shall require its personnel to agree to do likewise. Peerless shall take reasonable steps to identify for the benefit of CONSULTANT and its personnel any information of a competitively sensitive or proprietary nature, including by using confidentiality notices in written material where appropriate. These restrictions shall not be construed to apply to (1) information generally available to the public; (2) information released by Peerless generally without restriction; (3) information independently developed or acquired by CONSULTANT or its personnel without reliance in any way on other protected information of Peerless; or (4) information approved for the use and disclosure of CONSULTANT or its personnel without restriction. Notwithstanding the foregoing restrictions, CONSULTANT and its personnel may use and disclose any information (1) to the extent required by an order of any court or other governmental authority or (2) as necessary for it or them to protect their interest in this Agreement, but in each case only after Peerless has been so notified and has had the opportunity, if possible, to obtain reasonable protection for such information in connection with such disclosure.

7.2 CONSULTANT acknowledges that in order to perform the services called for in this Agreement, it shall be necessary for Peerless to disclose to CONSULTANT certain Trade Secrets, as defined in Section 7.3 hereof, that have been developed by Peerless at great expense and that have required considerable effort of skilled professionals. CONSULTANT further acknowledges that the Deliverables will of necessity incorporate such Trade Secrets. CONSULTANT agrees that it shall not disclose, transfer, use, copy, or allow access to any such Trade Secrets to any employees or to any third parties, except for those who have a need to know such Trade Secrets in order to accomplish the requirements of this Agreement and who are bound by contractual obligations of confidentiality and limitation of use sufficient to give effect to this Section 7. In no event shall CONSULTANT disclose any such Trade Secrets to any competitors of Peerless.

7.3 As used herein, the term “Trade Secrets” shall mean any scientific or technical or operational data, information, design, process, procedure, formula, or improvement that is commercially valuable to Peerless, is maintained in confidence by Peerless and is not generally known in the industry. The obligations set forth in Section 7.2 as they pertain to Trade Secrets shall survive termination of this Agreement and continue for so long as the relevant information remains a Trade Secret.

Section 8 - COMMUNICATIONS SYSTEMS AND ACCESS TO INFORMATION

8.1 CONSULTANT understands that CONSULTANT may receive access to Peerless’ computers and electronic communications systems (“systems”), including but not limited to voicemail, email, customer databases, and internet and intranet systems. Such systems are intended for legitimate business use related to Peerless’ business. CONSULTANT acknowledges that CONSULTANT does not have any expectation of privacy as between CONSULTANT and Peerless in the use of or access to Peerless’ systems and that all communications made with such systems or equipment by or on behalf of CONSULTANT are subject to Peerless’ scrutiny, use and disclosure, in Peerless’ discretion, but subject to a Confidential Disclosure Agreement executed between CONSULTANT and Peerless. Peerless reserves the right, for business purposes, to monitor, review, audit, intercept, access, archive and/or disclose materials sent over, received by or from, or stored in any of its electronic systems. This includes, without limitation, email communications sent by users across the internet and intranet from and to the www.peerless.com domain or any other domain. This also includes, without limitation, any electronic communication system that has been used to access any of Peerless’ systems.

CONSULTANT further agrees that CONSULTANT will use all appropriate security, such as, for example, encryption and passwords, to protect Peerless’ confidential information from unauthorized disclosure (internally or externally) and that use of such security does not give rise to any privacy rights in the communication as between CONSULTANT and Peerless. Peerless reserves the right to override any security passwords to obtain access to voicemail, email, computer (and software or other applications) and/or computer disks. CONSULTANT also acknowledges that Peerless reserves the right, for legitimate business purposes, to search all work areas (for example, offices, cubicles, desks, drawers, cabinets, computers, computer disks and files) and all personal items brought onto Peerless property or used to access Peerless information or systems.

Section 9 - CONFIDENTIALITY OF AGREEMENT; PUBLICITY; USE OF MARKS

9.1 For a period of five (5) years from the date of termination of this Agreement, CONSULTANT shall not disclose the nature of the effort undertaken for Peerless that is confidential or proprietary in nature or the terms of this Agreement to any other person or entity, except as may be necessary to fulfill CONSULTANT' s obligations hereunder.

9.2 CONSULTANT shall not at any time use Peerless' name or any Peerless trademark(s), service mark(s) or trade name(s) in any advertising or publicity without the prior written consent of Peerless.

Section 10 - WARRANTIES

10.1 Peerless warrants that it owns all right, title, and interest in and to any programs, systems, data, designs, or materials furnished to CONSULTANT hereunder.

10.2 CONSULTANT warrants that:

a. CONSULTANT' s performance of the services called for by this Agreement do not and shall not violate any applicable law, rule, or regulation; any contracts with third parties; or any third-party rights in any patent, trademark, copyright, design right, trade secret, or similar right; and

b. CONSULTANT is the lawful owner or licensee of any software programs or other materials used by CONSULTANT in the performance of the services called for in this Agreement, and

c. CONSULTANT has all rights, including, but not limited to community property rights, necessary to convey to Peerless the unencumbered ownership of Deliverables.

Section 11 - HIRING OF CONSULTANT' S PERSONNEL

11.1 Additional Value From Hiring. Peerless acknowledges that CONSULTANT provides a valuable service by identifying and assigning personnel for Peerless' work. Peerless further acknowledges that Peerless would receive substantial additional value, and CONSULTANT would be deprived of the benefits of its work force, if Peerless were to directly hire CONSULTANT' s personnel after CONSULTANT has introduced them to Peerless.

11.2 No Hiring Without Prior Consent. Without the prior written consent of CONSULTANT, Peerless shall not recruit or hire any personnel of CONSULTANT who are or have been assigned to perform work until one (1) year after termination of this Agreement.

11.3 Hiring Fee. In the event that Peerless hires any personnel of CONSULTANT who are or have been assigned to perform work for Peerless, Peerless shall pay CONSULTANT, within one (1) year of the date of such hiring, an amount equal to twenty-five percent (25%) of the total first year compensation Peerless pays such personnel as a fee for the additional benefit obtained by Peerless.

Section 12 - INDEMNIFICATION

12.1 CONSULTANT hereby indemnifies and agrees to hold harmless Peerless from and against any and all claims, demands, and actions, and any liabilities, damages, or expenses resulting therefrom, including court costs and reasonable attorney fees, arising out of or relating to the services performed by CONSULTANT hereunder or any breach of the warranties made by CONSULTANT pursuant to Section 10.2 hereof. CONSULTANT' s obligations under this Section 12.1 shall survive the termination of this Agreement for any reason. Peerless agrees to give CONSULTANT prompt notice of any such claim, demand, or action and shall, to the extent Peerless is not adversely affected, cooperate fully with CONSULTANT in defense and settlement of said claim, demand, or action.

Section 13 - LIMITATION OF LIABILITY

13.1 Disclaimer. EXCEPT AS EXPRESSLY PROVIDED IN THIS AGREEMENT, PEERLESS DOES NOT MAKE ANY WARRANTY, EXPRESS OR IMPLIED, WITH RESPECT TO THE DURATION OF THE SERVICES TO BE RENDERED.

THIS IS NOT AN EMPLOYMENT AGREEMENT.

13.2 Total Liability. Peerless agrees that CONSULTANT' s liability hereunder for damages, regardless of the form of action, shall not exceed the greater of $50,000.00 or the total amount paid for services under the applicable estimate or in the authorization for the particular service if no estimate is provided.

13.3 Force Majeure. Neither party shall be liable to the other party for any failure or delay caused by events beyond the parties' control, including, without limitation, the parties' failure to furnish necessary information; sabotage; failure or delays in transportation or communication; failures or substitutions of equipment; labor disputes; accidents; shortages of labor, fuel, raw materials or equipment; or technical failures.

Section 14 - MISCELLANEOUS

14.1 CONSULTANT shall not assign, transfer, or subcontract this Agreement or any of its obligations hereunder without the prior written consent of Peerless; provided, however, that CONSULTANT may assign its right to receive payments hereunder to such third parties as CONSULTANT may designate by written notice to Peerless.

14.2 This Agreement shall be governed and construed in all respects in accordance with the laws of the State of California as they apply to a contract executed, delivered, and performed solely in such State. [~Jurisdiction clause added for CONSULTANTS outside of CA].

14.3 The parties are and shall be independent contractors to one another, and nothing herein shall be deemed to cause this Agreement to create an agency, partnership, or joint venture between the parties. Nothing in this Agreement shall be interpreted or construed as creating or establishing the relationship of employer and employee between Peerless and either CONSULTANT or any employee or agent of CONSULTANT.

14.4 CONSULTANT shall, at its sole expense, obtain and carry in full force and effect, during the term of this Agreement, appropriate liability insurance coverage. Upon the request of Peerless, CONSULTANT shall provide Peerless with evidence satisfactory to Peerless of such insurance.

14.5 All remedies available to either party for one or more breaches by the other party are and shall be deemed cumulative and may be exercised separately or concurrently without waiver of any other remedies. The failure of either party to act in the event of a breach of this Agreement by the other shall not be deemed a waiver of such breach or a waiver of future breaches, unless such waiver shall be in writing and signed by the party against whom enforcement is sought.

14.6 All notices required or permitted hereunder shall be in writing addressed to the respective parties as set forth herein, unless another address shall have been designated, and shall be delivered by hand or by registered or certified mail, postage prepaid.

CONSULTANT
Denis W. Retoske, Sr., Attorney-at-Law,
A Professional Law Corporation
Attn.: Denis W. Retoske, Esquire
1850 Capri Circle
Costa Mesa, CA 92626
Tel; (714) 966-1866
FAX: (714) 966-1822

Peerless Systems Corporation
Attn.: Counsel
2381 Rosecrans Avenue
El Segundo, CA 90245
Tel: (310) 536-0908
FAX: (310) 536-0058

14.7 This Agreement constitutes the entire agreement of the parties hereto and supersedes all prior representations, proposals, discussions, and communications, whether oral or in writing. This Agreement may be modified only in writing and shall be enforceable in accordance with its terms when signed by the party sought to be bound.

14.8 This Agreement is enforceable only by CONSULTANT and Peerless. The terms of this Agreement are not a contract or assurance regarding compensation, continued employment, or benefit of any kind to any CONSULTANT' s personnel who are assigned to Peerless' work, or any beneficiary of any such personnel, and no such personnel, or any beneficiary thereof, shall be a third-party beneficiary under or pursuant to the terms of this Agreement.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed by their duly authorized representatives, on the date and year first above written.

Accepted and Agreed to by the parties as of the Effective Date.

DENIS W. RETOSKE, SR., ATTORNEY-AT-LAW, A PROFESSIONAL LAW CORPORATION.

By:

/S/ DENIS W. RETOSKE

(Authorized Signature)
Name: Denis W. Retoske
Title: President
Date: June ___, 2004

PEERLESS SYSTEMS CORPORATION

By:

/S/ HOWARD J. NELLOR

(Authorized Signature)
Name: Howard J. Nellor
Title: President and CEO
Date: June ___, 2004
///End

EXHIBIT A

1. Description of Work: Legal Services as to certain corporate matters as directed by the CEO, CFO and Directors of the Company

2. Schedule: Determined and agreed between the parties as to each particular assignment.

3. Cost: $225.00 per hour

4. Deliverables: As required by the elements of the particular project assigned by the Company and accepted by CONSULTANT.

5. Measurement Criteria: On-going.

EXHIBIT 10.90

Direct Dial: (310) 297-3287
Direct Fax: (310) 297-3142

March 28, 2005

<u>Via Certified Mail Return Receipt Requested</u>

Denis Retoske
A Professional Law Corporation
1850 Capri Circle
Costa Mesa, CA 92626

Re: Notice of Termination of Consulting Relationship

Dear Denis:

Peerless Systems Corporation (the "Company") has decided to terminate the Peerless/Consultant Consulting Agreement by and between you and the Company, dated as of June 4, 2004, and any addenda thereto (the "Agreement"). I' d like to take this opportunity to personally thank you for your service to the Company. It has been a pleasure working with you. Pursuant to Section 2.2 of the Agreement, the Company is required to provide fifteen (15) days prior written notice. Accordingly, the termination will become effective fifteen (15) days following your receipt of this letter.

I understand that you have previously spoken with Howard regarding the termination of your options to purchase shares of the Company' s common stock. This letter will also serve to confirm our mutual understanding that, in accordance with the terms of the Confidential Separation Agreement and Mutual Release by and between you and the Company, dated as of June 4, 2004, all of the outstanding options previously granted to you to purchase shares of the Company' s common stock will terminate on June 4, 2005. **Please note that because your options may only be exercised on a business day, your options must be exercised, if at all, no later than 5:00 p.m. PST on June 3, 2005**.

Naturally, if you have any questions regarding the above, please do not hesitate to contact me. I wish you all the best in your future endeavors.

Sincerely,

/S/ ELLIOT M. SHIRWO

Elliot M. Shirwo
Assistant General Counsel

cc: Howard J. Nellor

EXHIBIT 21

Registrant' s Wholly-Owned Subsidiaries:

Peerless Systems Imaging Products, Inc., a Washington corporation

Peerless Systems K.K., a Japanese corporation

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 333-13773, 333-63967, 333-82323, 333-57362, 333-73562, 333-97265, 333-111000) of our report dated March 17, 2005, with respect to the consolidated financial statements and schedule of Peerless Systems Corporation included in the Annual Report (Form 10-K) for the year ended January 31, 2005.

/s/ Ernst & Young llp

Los Angeles, California
April 28, 2005

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Howard J. Nellor, certify that:

1. I have reviewed this annual report on Form 10-K of Peerless Systems Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

5. The registrant' s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of registrant' s board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: May 2, 2005

/s/ Howard J. Nellor
Howard J. Nellor
President and Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, William R. Neil, certify that:

1. I have reviewed this annual report on Form 10-K of Peerless Systems Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant' s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter (the registrant' s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant' s internal control over financial reporting; and

5. The registrant' s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of registrant' s board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control over financial reporting.

Date: May 2, 2005

/s/ William R. Neil
William R. Neil
Chief Financial Officer
(Principal Financial Officer)

EXHIBIT 32

The following certifications are being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officers of Peerless Systems Corporation, a Delaware corporation (the "Company"), hereby certify, to each such officer' s knowledge, that:

(i) the accompanying Annual Report on Form 10-K of the Company for the quarter and year ended January 31, 2005 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 2, 2005

/s/ Howard J. Nellor
Howard J. Nellor
President and Chief Executive Officer
(Principal Executive Officer)

Dated: May 2, 2005

/s/ William R. Neil
William R. Neil
Chief Financial Officer
(Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to Peerless Systems Corporation and will be retained by Peerless Systems Corporation and furnished to the Securities and Exchange Commission or its staff upon request.