

RDM CORPORATION – Third Quarter Fiscal 2005 Report MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), prepared as of July 28, 2005, comments on the consolidated operations, performance and financial condition of RDM Corporation. ("RDM" or the "Company") for the three and nine months ended June 30, 2005 and June 30, 2004. This MD&A should be read in conjunction with the unaudited consolidated financial statements of RDM Corporation ("the Company") including the notes thereto for the three and nine months ended June 30, 2005 and should also be read in conjunction with the audited consolidated financial statements and Management's Discussion and Analysis for the fiscal year ended September 30, 2004 as set out in the Company's 2004 Annual Report. All currency amounts in this MD&A are stated in Canadian dollars, unless otherwise indicated. Neither this MD&A or accompanying consolidated interim financial statements have been reviewed or audited by the Company's external auditors. Certain statements contained in the following Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements, including (without limitation) statements concerning possible or assumed future results of operations of the Company preceded by, followed by or that include the words "believes", "expects", "anticipates", "estimates", "intends", "plans" or similar expressions. Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions and the Company's actual results may differ materially from those anticipated in these forward-looking statements. The Company does not intend, and does not assume any obligation, to update these forward-looking statements. Additional information relating to the Company and the risks inherent in its business is provided in the Company's Annual Information Form and other documents available on SEDAR at www.sedar.com and on the Company's website at www.rdmcorp.com.

Company Overview

RDM is a leading provider of solutions for the electronic commerce and payment processing industries. RDM has pioneered Electronic Cheque Conversion systems and web-based image management and transaction processing services for retailers, banks, payment processors and government agencies, as well as print quality control and image quality systems for a variety of global customers.

RDM evaluates operational performance based on three operating segments: Digital Imaging, Electronic Payments Solutions, and Quality Assurance. The segments are managed separately because each segment requires unique marketing strategies and each segment is exposed to different economic environments. The Digital Imaging segment produces electronic document scanners and provides related Image and Transaction Management Services ("ITMS") to financial institutions and financial services providers. The Electronic Payments Solutions segment develops customer-specific electronic payment and e-commerce systems based on core RDM technologies to facilitate business-to-business and business-to-consumer electronic transactions. The Quality Assurance segment designs and manufactures test equipment that is used with the Company's proprietary software and algorithms to determine whether cheques and other financial documents have been designed or printed to applicable industry standards.

RDM also holds an 18% interest in Xign Corporation (13% on a fully diluted basis), a private U.S. based company that has developed a proprietary business-to-business e-commerce payment network for Fortune 500 and other companies.

Overall Performance and Industry Trends

Electronic Payments Solutions had a strong quarter as the Company continues to work with U.S. government agencies and marquee U.S. banks on their Check 21 initiatives and Quality Assurance segment results were in line with Management's expectations. Digital Imaging segment results were, however, significantly below Management's expectations for the quarter. Although ITMS volume experienced continued growth, scanner sales were lower than expected due to weaker than anticipated demand in the Point of Presentment ("POP") market. ITMS transaction volume for the third quarter 2005 averaged over 415,000 items per week, compared to 400,000 items in the second quarter of fiscal 2005, and 250,000 items in the third quarter of fiscal 2004. The Quality Assurance and Electronic Payments

Solutions business results in the third quarter of fiscal 2005 continued to fund the Company's investment in the Digital Imaging business.

The main challenge the Company faced in the third quarter of fiscal 2005 was a softening of demand in the POP market while at the same time the Company's bank customers continue to be slower than expected in rolling out both ITMS and associated document scanners to their corporate customers. The Company now has several top ten banks in the U.S. using RDM's ITMS and although the number of "early adopter" end-users of ITMS has increased significantly, bank product roll-outs continued to be slower than expected which hampered the Company's overall revenue growth in the third quarter of fiscal 2005.

Management still believes the most significant trend impacting the U.S. payments industry continues to be the Check Clearing for the 21st Century Act ("Check 21") which became effective October 28, 2004. Check 21 grants Image Replacement Documents ("IRD's") the same legal status as the original paper version. Although the full impact of Check 21 still remains to be seen, Management believes that the Company is well positioned to be a provider of choice to the U.S. payments industry as both the Company's small document imagers and ITMS are well positioned for the industry shift towards a distributed image capture and processing model and the accelerated adoption of Electronic Cheque Conversion.

Summary of Quarterly Results and Selected Financial Information

i) *Select Unaudited Consolidated Quarterly Financial Information*

| <i>Amounts in Canadian, In Thousands, Except Per Share Amounts</i> | Fiscal 2004 as restated; (see note 6 to the Company's June 30, 2005 unaudited interim consolidated financial statements) | | | | | | | |
|--|---|-------------|-----------|----------|--------------|-------------|----------|----------|
| | Fiscal 2003 | Fiscal 2004 | | | | Fiscal 2005 | | |
| | September 30 | December 31 | March 31 | June 30 | September 30 | December 31 | March 31 | June 30 |
| Revenue | \$ 3,563 | \$ 3,429 | \$ 4,444 | \$ 5,380 | \$ 4,078 | \$ 4,344 | \$ 4,718 | \$ 4,133 |
| Net earnings (loss) | \$ 165 | \$ (333) | \$ (159) | \$ 335 | \$ 271 | \$ (199) | \$ 244 | \$ 88 |
| Earnings (loss) per share: | \$ 0.01 | \$ (0.02) | \$ (0.01) | \$ 0.02 | \$ 0.02 | \$ (0.01) | \$ 0.01 | \$ 0.00 |
| basic | | | | | | | | |
| Earnings (loss) per share: | \$ 0.01 | \$ (0.02) | \$ (0.01) | \$ 0.02 | \$ 0.02 | \$ (0.01) | \$ 0.01 | \$ 0.00 |
| diluted | | | | | | | | |
| Total assets | \$18,356 | \$18,613 | \$19,058 | \$20,496 | \$20,194 | \$20,225 | \$20,578 | \$20,373 |

ii) *Revenues and Operating Results*

For the three months ended June 30, 2005, total revenue was \$4.1 million compared with \$5.4 million for the three months ended June 30, 2004, a decrease of 23%. Gross profit decreased \$328,000 or 14% to \$2.0 million, while as a percentage of revenues, gross profit for the third quarter of 2005 increased to 47% of revenues compared to 42% in 2004, primarily due to the higher relative percentage of Electronic Payments Solutions revenue in fiscal 2005.

For the three months ended June 30, 2005, net earnings were \$88,000 compared to net earnings of \$335,000 in the third quarter of 2004. The Quality Assurance and Electronic Payments Solutions businesses continued to contribute positively to fund the Company's investment in Digital Imaging research and development. Net earnings of \$88,000 for the third quarter of fiscal 2005 were net of \$300,000 in non-cash operating expenses such as depreciation and amortization and stock-based compensation.

Electronic Payments Solutions segment revenues decreased \$321,000 or 16% to \$1.7 million in the third quarter of 2005 primarily due to variations in degrees of progress on custom development projects as compared to the comparative quarter. On a year-to-date basis, the segment is well ahead of the previous year and Management expects that fiscal 2005 revenues will exceed fiscal 2004 levels. The Company continues to work closely with senior U.S. Government agencies and U.S. financial institutions to apply innovative RDM solutions to improve the infrastructure of the U.S. payments system. The Company is pleased with the segment's year-to-date revenue performance and \$1.1 million third quarter 2005 operating contribution, and expects that Electronic Payments Solutions results will continue to be strong throughout the remainder of 2005 as both the U.S. government and private sector financial institutions continue to engage RDM for their custom development project needs.

Quality Assurance segment revenue increased \$52,000 or 10% in the third quarter of 2005 to \$579,000. The Quality Assurance segment remained profitable, contributing \$114,000 to third quarter 2005 operations. Quality Assurance sales do fluctuate from quarter to quarter, and on a year-to-date basis the Quality Assurance segment's results remain strong and the segment is also ahead of the previous year. Management believes that the Quality Assurance business will continue to generate revenues of approximately \$500,000 each quarter and continue to contribute to overall corporate profitability.

Digital Imaging segment revenues decreased \$978,000 or 35% in the third quarter of 2005 to \$1.8 million. Overall, the Digital Imaging segment posted an operating loss of \$1.1 million in the third quarter of 2005 compared to a loss of \$846,000 in the comparative third quarter of 2004. While ITMS volumes did increase 65% from the same period in fiscal 2004, scanner shipments declined 35% as the hardware group experienced a disappointing quarter, primarily due to the lower than expected bank rollouts and a softening of demand in the POP market. As well, in previous quarters the Digital Imaging sales team was both incented and focused on securing marquee banks as ITMS customers. Now that the Company has been successful in this regard, these resources are being redeployed in the fourth quarter to focus on improving scanner revenue performance.

The Company has chosen to reflect custom development revenue from financial institution customers that sign on for ITMS services in Electronic Payments Solutions segment results while Digital Imaging continues to bear the majority of the Company's research and development expenditures. Although the Company segments its operations in this manner, Management continues to believe that the results of Digital Imaging and Electronic Payments Solutions should be viewed in tandem when evaluating overall Company performance.

The Company still believes that the continued adoption of Check 21 will contribute to a number of customers increasing their commitment to Electronic Cheque Conversion, however, both ITMS adoption and scanner sales are and will continue to be impacted by the Company's bank customers' slower than anticipated rollouts to their corporate clients. Although Check 21 is gaining momentum, now that the Company has been successful in gaining a foothold in the market by signing up a significant number of financial institution customers as distribution partners, the next step is to increase both ITMS volumes and scanner sales as these financial institutions roll out their service offerings to their corporate clients. Bank product sales cycles can be lengthy, and in the interim the Company continues to explore complementary distribution channels and has also begun targeting end users directing through other Value Added Resellers (VAR's) to help create pull in the marketplace and encourage the banks to expedite their rollouts by increasing bank customers' demand.

For the nine months ended June 30, 2005, the Company's consolidated revenues remained stable at \$13.2 million. Net earnings for the nine months ended June 30, 2005 were \$133,000 versus a net loss of \$157,000 in the comparative nine month period, primarily due to the Company's continued execution on its strategy of maintaining cash positive operations.

ii) Review of Functional Operating Expenses

For the three months ended June 30, 2005, sales and marketing expenses decreased \$70,000 or 11% to \$578,000, primarily due to lower sales commissions on lower scanner sales.

Research and development expenses decreased \$72,000 or 9% to \$736,000, as while the Company continued to invest in new product development, primarily Versions 2.0 and 2.1 of the Company's Image & Transaction Management System and the Company's new EC7000 dual-sided scanner, certain development resources were redeployed to work on customer-funded projects.

General and administration expenses increased \$110,000 or 51% to \$326,000. General and administration expenses in the third quarter of 2005 were in line with the Company's typical quarterly level of general and administration expenditures, while third quarter 2004 general and administration expenses were unusually low due to the timing of certain professional services expenditures in fiscal 2004. On a year-to-date basis, general and administration expenses are 7% higher than the previous year due to higher regulatory, compliance, and audit costs and Management expects that quarterly general and administration expenses will continue to approximate third-quarter 2005 levels.

Depreciation and amortization expenses increased \$13,000 or 5% to \$250,000, as a result of higher tooling depreciation expenses associated with the Company's EC6000 and Synergy products.

Stock-based compensation decreased 29% to \$50,000 reflecting the Company's adoption of CICA Handbook Section 3870 and reduced option grants in fiscal 2005. For further information, refer to note 6 of the Company's June 30, 2005 interim consolidated financial statements. Interest and other increased \$42,000 primarily due to higher interest income from cash and cash equivalents.

Liquidity

The Company has historically financed its operations primarily through the sale of capital stock and operating cash flow. For the third quarter ended June 30, 2005, cash provided by operations was \$291,000 compared with cash provided by operations of \$819,000 in the third quarter of fiscal 2004. In the third quarter of 2005, \$205,000 was expended on capital asset additions, primarily ITMS related hardware and software and leasehold improvements for building additions to house an expanded Electronic Payments Solutions group.

At June 30, 2005 the Company held cash and cash equivalents of \$4.6 million, an increase of \$86,000 from the \$4.5 million on hand at March 31, 2005. At June 30, 2005 the Company had working capital of \$9.8 million as compared to working capital of \$9.6 million at March 31, 2005.

Capital Resources

The Company has a \$1 million operating credit facility, which was unused at June 30, 2005. Under this facility, the Company is required to maintain certain financial ratios, which the Company has met as of June 30, 2005.

At June 30, 2005 the Company has 19,995,076 common shares outstanding and 22,539,076 common shares outstanding on a fully diluted basis. Even though the Company has been successful in raising equity capital in the past, the Company intends to continue to review its level of operating costs, restrict the acquisition of capital assets to match the replacement cycle of its current and future product offerings, and continue to drive operations with cash-positive earnings where possible. The Company currently has no significant commitments for capital expenditures, but expects that in future periods there may be additional capital expenditures necessary to service the Company's ITMS operations. Management plans to review these planned expenditures and their impact on capital requirements during its annual fall budgeting process and provide an update in the Company's year-end MD&A.

Management currently believes that its current working capital and anticipated operating cash flow will be sufficient to meet its working capital and capital expenditure requirements for the remainder of fiscal 2005. The Company also believes, based on current estimates, that its current cash balances and anticipated cash flows from operations, if any, will be sufficient to meet its working capital and capital expenditure requirements for at least the next twelve months. Thereafter, or if the Company's revenue forecasts or spending plans change, the Company may find it necessary to seek additional sources of financing to support its capital needs. If the Company does need to seek additional financing, there is no assurance that this additional financing will be available in the amounts or on terms favourable to the Company and not but dilutive to the Company's shareholders.

Several key factors that could impact the liquidity of the Company are the Company's ability to achieve sustainable profitability; fluctuations in exchange rates, particularly between the US dollar and the Canadian dollar; the long sales cycles associated with selling to financial institutions and their ability to successfully roll-out ITMS and scanners to their customers; and the relative strength of the North American economy where the Company derives approximately 95% of its revenue.

Contractual Obligations and Off-Balance Sheet Arrangements

The Company realizes a significant portion of its revenue in United States dollars and incurs expenses in Canadian dollars. The Company utilizes forward exchange contracts to hedge the cash flow risk associated with forecasted transactions in foreign currencies but does not enter into derivatives for speculative purposes.

The Company does not enter into off-balance sheet arrangements, other than derivative foreign exchange contracts, purchase commitments for inventory and capital assets and operating leases for certain ITMS and office equipment, and facility leases. Contractual obligations of the Company at June 30, 2005 are as follows:

| Contractual Obligations | Payments Due By Period | | | Total |
|--|------------------------|--------------------|--------------------|-------------|
| | Less Than One Year | One to Three Years | Four to Five Years | |
| Inventory and Capital Asset Purchase Obligations | \$1,850,000 | \$ 650,000 | \$ - | \$2,500,000 |
| Operating Lease Obligations | 90,000 | 120,000 | \$ - | 210,000 |
| | \$1,940,000 | \$ 770,000 | \$ - | \$2,710,000 |

The Company utilizes derivative financial instruments to manage a portion of its foreign exchange exposure. The use of derivative financial instruments is limited to risk management activities and is subject to Management and Board controls and approvals. At June 30, 2005 the Company has outstanding through June 30, 2006 U.S. \$7.2 million foreign exchange contracts at rates ranging from CDN \$0.80 to CDN \$0.81, with an average rate of CDN \$0.81. The Company is exposed to credit risk on derivative financial instruments arising from the potential for counterparties to default on their contractual obligations to the Company. The Company minimizes this risk by limiting counterparties to these contracts to Canadian Schedule A Chartered Banks.

Outlook for the Remainder of Fiscal 2005

The Company's current business model centers on investing in Digital Imaging sales, marketing and development while attempting to maintain positive Electronic Payments Solutions and Quality Assurance earnings and cash flows. The Company expects to execute on this plan throughout the remainder of fiscal 2005, however the Company does not provide specific guidance with respect to its expectations for revenue or operating results for future periods.

While overall profitability remains a key fiscal 2005 objective for the Company, the Company's ability to achieve revenue growth over the previous year and maintain the Company's track record of profitability is contingent upon improvements in fourth quarter revenue performance, particularly in the Company's Digital Imaging segment. While the Company's long-term prospects remain strong, there remains a risk that aforementioned efforts to improved the scanner sales team's revenue performance in the fourth quarter may not translate into immediate short-term results and revenue growth.

As discussed in the Company's fiscal 2004 annual report and previous MD&A, the second challenge to fiscal 2005 profitability continues to be instability in the Canadian dollar. The Company's internal revenue growth and profitability targets are based on an operating plan that assumed an average fiscal 2005 exchange rate of \$1 USD = \$0.80 CDN. For each one-cent increase in the Canadian dollar, the Company estimates that revenues and earnings are impacted by \$250,000 and \$175,000 respectively. Should the Canadian dollar rise above \$0.85 for a prolonged period of time, the Company's operations could be significantly negatively impacted since the majority of the Company's revenues are denominated in US dollars while the majority of the Company's expenses are denominated in Canadian dollars. Management's strategy as the Canadian dollar rises is to i) Hedge a significant portion of the Company's U.S. dollar revenues, and ii) Endeavor to source additional custom development opportunities at higher margins to mitigate gross margin pressure that accompanies a rising Canadian dollar.

Critical Accounting Policies and Estimates

The Company's financial statements are prepared in accordance with Canadian generally accepted accounting principles. The preparation of these financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Management bases its estimates on historical experience and other assumptions that it believes are reasonable in the circumstances. Actual results may differ from the estimates. The following accounting policies reflect the more significant estimates and assumptions used in the preparation of the Company's financial statements.

i) Revenue Recognition

Revenue recognition is critical because it is a key indicator of the Company's financial performance. Management follows specific guidelines in recognizing revenue and makes estimates and assumptions that affect the reported amounts of revenue. A delay in recognizing revenue could cause operating results to vary significantly from quarter to quarter.

The Company's revenues are derived from product sales and technology licenses, service revenues, transaction fees, and custom development contracts. The Company's operating segments typically derive their revenues from the following sources:

| Operating Segment | Revenues |
|-------------------------------|---|
| Digital Imaging | - Product sales and transaction fees |
| Quality Assurance | - Product sales, service revenues and technology licenses |
| Electronic Payments Solutions | - Custom development contracts |

Revenue from product sales and technology licenses is recognized upon delivery, provided that no significant obligations on the part of the Company remain and collection of the related receivable is deemed probable by management. Service revenue is recognized ratably over the term of the related agreement, which is typically twelve to twenty-four months.

Revenue from transaction fees is recognized as services are provided and when collection of the related receivable is considered probable by management. Custom development contract revenue is recognized using the percentage of completion method. Revisions in custom development and profit estimates, which can be significant, are reflected in the accounting period in which the relevant facts become known.

Revenue that has been prepaid but does not yet qualify for recognition as revenue under the Company's revenue recognition policies is reflected as deferred revenue.

ii) Allowance for Doubtful Accounts

Allowance for doubtful accounts relate to estimated losses that may arise if any customers are unable to make required payments. Management specifically analyzes the age of outstanding customer balances, historical bad debt experience, customer credit-worthiness and changes in customer payment terms when making estimates of the uncollectability of the Company's amounts receivable balance. If the

Company determines that the financial condition of any of its customers deteriorates, increases in the allowance are made.

iii) Impairment of Inventories and Capital Assets

Whenever events or changes in circumstances indicate that the carrying value of inventories or capital assets may not be recoverable, the Company assesses the impairment of these assets. Factors the Company considers important include significant underperformance relative to plan, a change in the Company's business strategy, or significant negative industry or economic trends. When the Company believes that the carrying value of inventories or capital assets may not be recoverable based upon the existence of one or more of the above indicators of potential impairment, the Company determines what impairment, if any, exists and provides for such impairment in the period known.

iv) Investment in Xign Corporation

The Company holds an interest in Xign Corporation, a privately held California-based technology company that does not publicly disclose detailed financial results. However, Management understands Xign is still an early stage company, with under U.S. \$5 million in total revenues in their most recently completed fiscal year ended December 31, 2004. The Company's investment in Xign Corporation is accounted for using the cost method, whereby any earnings from the Company's investment are recognized only to the extent dividends are received. To date there have been no dividends declared and the Company does not expect dividends to be declared in the foreseeable future. The Company's policy is to review the carrying value of Xign annually, or when information is received that may indicate an impairment exists, to determine if any impairment provision is required. This review is based on available internal Xign financial information and Xign's progress against its operating plan.

Changes in Accounting Policies

The only material change in accounting policies since September 30, 2004 was the adoption of CICA Handbook Section 3870; *Stock-Based Compensation*, effective October 1, 2003. The result of this change in accounting policy is that the value of stock options granted subsequent to the date of adoption are recorded in the Consolidated Statement of Operations as an expense rather than disclosed in the Company's financial statements notes as was the Company's previous policy. For further information, refer to Note 6 of the Company's June 30, 2005 unaudited interim consolidated financial statements.