RDM CORPORATION – Third Quarter Fiscal 2006 Report

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

The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements of RDM Corporation ("the Company") including the notes thereto for the three months ended June 30, 2006 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, 2005 as set out in the Company's 2005 Annual Report. Neither this MD&A or accompanying consolidated interim financial statements have been reviewed nor 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. 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 Remote Cheque Deposit 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 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 and operates a proprietary business-to-business e-commerce payment network for Fortune 500 and other companies. Further information is available at www.xign.com.

Overall Performance and Industry Trends

The Company's overall performance for the three months ended June 30, 2006 was very strong, despite the continued strengthening of the Canadian dollar. Both scanner sales and ITMS volume experienced growth compared to the second quarter of 2006 and the third quarter of 2005. ITMS transaction volume for the third quarter 2006 averaged 689,000 items per week, compared to 618,000 items in the second quarter of 2006, and 415,000 items in the third quarter of 2005. Electronic Payments Solutions segment results were slightly below expectations. Quality Assurance enjoyed a stronger quarter. Management 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 expects 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 an industry shift towards a distributed image capture and processing model and the accelerated adoption of Electronic Cheque Conversion. The Company continues to invest in ITMS to build a growing recurring revenue base.

Summary of Quarterly Results and Selected Financial Information

i) Revenues and Operating Results

For the three months ended June 30, 2006, total revenue was $6.2 million compared with $4.1 million for the three months ended June 30, 2005, an increase of 50%, in spite of the strengthening of the Canadian dollar. Gross profit increased $.5 million to $2.4 million, while as a percentage of revenues, gross profit for the third quarter of 2006 was 39% of revenues, compared to 47% in the third quarter of 2005, due to a change in mix of business segments. Electronic Payment Solutions and Quality Assurance segments realize higher margins than the Digital Imaging Segment which enjoyed strong growth.

For the three months ended June 30, 2006, the Company's net earnings were $236,000 compared to net earnings of $88,000 in the third quarter of 2005. The Quality Assurance and Electronic Payments Solutions businesses continue to mitigate the impact of the Company's investment in Digital Imaging research and development. The earnings of $236,000 for the third quarter of fiscal 2006 were net of $455,000 in non-cash operating expenses such as depreciation and amortization, stock-based compensation, and unrealized foreign exchange losses. Unrealized foreign exchange losses were $132,000.

Electronic Payments Solutions segment revenues decreased $256,000 or 15% to $1.5 million in the third quarter of 2006 compared to the third quarter of 2005. 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.

Quality Assurance segment revenue decreased $3,000 or in the third quarter of 2006 to $576,000 as compared to the third quarter of 2005. Third quarter 2006 revenues for the segment were in line with management's expectations that the division will generate revenues of approximately $500,000 each quarter. The Quality Assurance segment remained profitable, contributing $182,000 to third quarter 2006 operations compared to $114,000 in the same period last year.

Digital Imaging segment revenues increased $2,313,000 or 126% to $4.2 million in the third quarter of 2006 compared to the third quarter of 2005. Increasing adoption of remote deposit capture services is fueling demand for both ITMS and scanner sales compared to the third quarter of 2005. Overall, the Digital Imaging segment reduced its operating loss by $755,000 to $368,000 in the third quarter of 2006 compared to 2005. The company expects a stronger fourth quarter due to a significant scanner order backlog.

The Company has chosen to include custom development revenue from financial institution customers that sign on for ITMS in Electronic Payments Solutions segment results. As well, Digital Imaging bears the majority of the Company's research and development expenditures. Although the Company segments its operations in this manner, the Company continues to believe the results of Digital Imaging and Electronic Payments Solutions should be viewed in conjunction when evaluating overall Company performance. The combined operating results from these two divisions improved from a loss of $27,000 in the third quarter of fiscal 2005 to earnings of $226,000 in the third quarter of fiscal 2006.

For the nine months ended June 30, 2006, the Company's consolidated revenues increased 30% to $17.1 million from $13.2 million, primarily due to a stronger year-to-date performance of the Digital Imaging business. Earnings for the nine months ended June 30, 2006 were $435,000 versus earnings of $133,000 in the comparative nine month period in 2005, with the majority of the improvement due to strong Digital Imaging year-to-date results.

ii) Functional Operating Expenses

For the three months ended June 30, 2006, sales and marketing expenses increased $168,000 or 29% to $746,000 primarily due to increased sales efforts and activities related to the company's 50% increase in overall revenues.

Research and development expenses were unchanged at $736,000 as the Company continued to invest in new product development, primarily a Web-based version of the Company's Image & Transaction Management System.

General and administration expenses decreased $42,000 or 13% to $284,000.

Depreciation and amortization expenses increased $3,000 or 1% to $253,000.

Stock-based compensation increased $20,000 to $70,000. For further information, refer to note 5 of the Company's June 30, 2006 interim consolidated financial statements.

Interest and other expenses increased $154,000, primarily due to unrealized foreign exchange loss of 132,000 in the third quarter of 2006 compared to an unrealized foreign exchange gain of $9,000 in 2005.

Liquidity

The Company has historically financed its operations primarily through the sale of capital stock and operating cash flow. For the quarter ended June 30, 2006, cash used in operations was $1.9 million compared with $.3 million provided from operations in the third quarter of its previous fiscal year. Accounts receivable increased due to the increase in sales and timing of collections from several customers. In July 2006, the Company collected $1,525,000 from 2 customers that contributed to a significant portion of the increase in the accounts receivable at June 30, 2006. In the third quarter of 2006, $159,000 was expended on capital asset additions, primarily ITMS related hardware and software and patents.

Working capital increased to $11.7 million at June 30, 2006, from $11.3 million at March 31, 2006. At June 30, 2006 the Company held cash and cash equivalents of $4.3 million, a decrease of $2 million from the $6.3 million on hand at March 31, 2006.

The Company's current business model centers on investing in Digital Imaging sales, marketing and development while working 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 2006, with an objective of overall fiscal 2006 consolidated profitability. As discussed in the Company's fiscal 2005 annual report, the biggest challenge to fiscal 2006 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 2006 exchange rate of $.90 USD = $1 CDN before considering the impact of the $7.2 million in foreign exchange contracts. Should the Canadian dollar rise above $.90 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. The Company'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.

Capital Resources

The Company has a $1 million operating credit facility, which was unused at June 30, 2006. Under this facility, the Company is required to maintain certain financial ratios, which the Company has met as of June 30, 2006.

At June 30, 2006, the Company has 20 million common shares outstanding and 22.5 million 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 business segment.

Off Balance Sheet Arrangements and Commitments

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 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. The Company has outstanding through June 30, 2007 U.S. $8.7 million foreign exchange contracts at exchange rates ranging from CDN $1.20 to CDN $1.10 to US $1.00, with an average rate of $1.14. The increase in contracts is to hedge the higher level of non-monetary $US assets at June 30, 2006. 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.

The Company has $4.5 million in outstanding purchase order commitments and operating leases for the purchase of inventories and capital assets in the normal course of operations. The amount is higher than the prior quarter due to a scanner order backlog. The Company attempts to manage lead-times associated with sourcing its EC6000, EC7000 and RDM Synergy raw material components with staggered deliveries on these commitments wherever possible.

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 as 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. Xign is still an early stage company, with approximately $5 million U.S. in revenues in their most recently completed fiscal year ended December 31, 2005. 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

There have been no material changes in accounting policies since September 30, 2005.

RDM CORPORATION

Consolidated Balance Sheets

(Amounts In Canadian Dollars, In Thousands, Except Share and Per Share Amounts)

	June 30 2006 (Unaudited)		September 30 2005 (Audited)	
Assets:				
Current assets:				
Cash and cash equivalents	$	4,312	$	5,466
Accounts receivable		6,981		3,396
Inventories		3,360		3,971
Other		312		168
Total current assets		14,965		13,001
Long-term investment		6,379		6,379
Capital assets		2,004		2,304
Total assets	$	23,348	$	21,684
Liabilities and shareholders' equity:				
Current liabilities:				
Accounts payable and accrued liabilities	$	2,701	$	1,972
Deferred revenue		565		529
Total current liabilities		3,266		2,501
Shareholders' equity:				
Share capital *(note 4 and 5)*		26,345		26,135
Contributed surplus		771		575
Deficit		(6,977)		(7,412)
Share purchase loans		(57)		(115)
Total shareholders' equity		20,082		19,183
Total liabilities and shareholders' equity	$	23,348	$	21,684

See accompanying notes.

RDM CORPORATION
Consolidated Statements of Operations and Deficit
(Amounts In Canadian Dollars, In Thousands, Except Share and Per Share Amounts)

	Three Months Ended June 30		Nine Months Ended June 30	
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)	2005 (Unaudited)
Revenue	$ 6,187	$ 4,133	$ 17,095	$ 13,195
Cost of revenue	3,785	2,182	10,115	7,325
Gross profit	2,402	1,951	6,980	5,870
Operating expenses:				
Sales and marketing	746	578	2,006	1,763
Research and development	736	736	2,590	2,405
General and administration	284	326	1,078	878
Depreciation and amortization	253	250	687	598
Stock-based compensation (note 5)	70	50	186	180
Interest and other (note 3)	77	(77)	(2)	(87)
	2,166	1,863	6,545	5,737
Earnings from operations	236	88	435	133
Income taxes	-	-	-	-
Net earnings	236	88	435	133
Deficit, beginning of period	$ (7,213)	$ (8,124)	$ (7,412)	$ (8,169)
Deficit, end of period	$ (6,977)	$ (8,036)	$ (6,977)	$ (8,036)
Earnings per share – basic	$0.01	$0.00	$0.02	$0.01
Earnings per share – diluted (note 4)	$0.01	$0.00	$0.02	$0.01

See accompanying notes.

RDM CORPORATION
Consolidated Statements of Cash Flow
(Amounts in Canadian Dollars, In Thousands, Except Share and Per Share Amounts)

	Three Months Ended June 30 2006 (Unaudited)	Three Months Ended June 30 2005 (Unaudited)	Nine Months Ended June 30 2006 (Unaudited)	Nine Months Ended June 30 2005 (Unaudited)
Cash provided by (used in):				
Operations:				
Net earnings	$ 236	$ 88	$ 435	$ 133
Items not involving cash:				
Depreciation and amortization	253	250	687	598
Change in non-cash operating working capital	(2,415)	(105)	(2,343)	(1,077)
Stock-based compensation	70	50	186	180
	(1,856)	283	(1,035)	(166)
Financing:				
Issuance of share capital, net of issue costs	-	-	210	1,411
Repayment of share purchase loans	22	8	58	77
	22	8	268	1,488
Investing:				
Purchase of capital assets	(159)	(205)	(387)	(724)
Increase (Decrease) in cash	(1,993)	86	(1,154)	598
Cash and cash equivalents, beginning of period	6,305	4,521	5,466	4,009
Cash and cash equivalents, end of period	$ 4,312	$ 4,607	$ 4,312	$ 4,607

See accompanying notes.

RDM CORPORATION
Notes to Consolidated Financial Statements
(Amounts in Canadian Dollars, In Thousands, Except Share and Per Share Amounts)

1. Basis of preparation

These interim consolidated financial statements have been prepared by the Management of RDM Corporation and have not been audited or reviewed by the Company's external auditors.

2. Significant accounting policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial information. The accounting policies used in the preparation of these interim consolidated financial statements conforms to those used in the Company's annual consolidated financial statements. These financial statements do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements and have not been audited or reviewed by the Company's external auditors. These interim consolidated financial statements and notes thereto should be read in conjunction with the Company's consolidated financial statements for the year ended September 30, 2005.

3. Interest and other

Interest and other for the third quarter of fiscal 2006 includes $132 with respect to unrealized foreign exchange losses (2005 – unrealized foreign exchange gains of $31). Interest and other for the nine month period ended June 30, 2006 includes $145 with respect to unrealized foreign exchange losses (2005 – unrealized foreign exchange gains of $9).

4. Loss per share information and outstanding share capital

	Three Months Ended June 30		Nine Months Ended June 30	
Diluted loss per share information	2006	2005	2006	2005
Weighted average common shares outstanding during the period	20,247,826	20,079,076	20,121,451	20,064,576
Earnings per share – diluted	$ 0.01	$ 0.0	$ 0.02	$ 0.01

Outstanding Share Capital	June 30 2006	September 30 2005
Common shares	20,247,826	19,995,076
Common share stock options	1,500,000	1,844,000
Share purchase warrants	700,000	700,000

Issuances of share capital

i) On December 23, 2004, the Company issued 1,400,000 common shares and 700,000 common share purchase warrants for gross proceeds of $1.4 million (net proceeds of $1.375 million, after issue costs). The share purchase warrants, which have an exercise price of $1.35 each, are convertible into common shares of the Company at the holder's option on a one for one basis at any time up to December 23, 2006.

ii) On November 30, 2005 the Company issued 590,000 options at an exercise price of $.92 to certain executives.

iii) In connection with their annual remuneration, on January 20, 2006 directors of the Company were issued 125,000 options to purchase common shares of the Company at an exercise price of $1.05 per share.

iv) On February 9, 2006 the Company issued $100,000 options at an exercise price of $1.30 to certain executives.

v) During the three months ended June 30, 2006, no common shares were issued pursuant to the exercise of outstanding options to purchase common shares.

5. Stock-based compensation

The Company has adopted CICA Handbook Section 3870; *Stock-Based Compensation*, effective October 1, 2004. The value of all stock options granted subsequent to October 1, 2002 is recorded in the Consolidated Statement of Operations as a stock compensation expense.

The impact of this change in policy was to increase both share capital and deficit at October 1, 2003. The following table illustrates significant assumptions underlying the Company's accounting policy for stock-based compensation:

	Three Months Ended June 30, 2006	Nine Months Ended June 30, 2006
Weighted average fair value of each option	$ --	$ .51
Assumptions:		
Volatility	--	58.8%
Risk free interest rate	--	3.8%
Expected life in years	--	4.7
Expected dividend yield	--	0%

No options were granted in the three months ended June 30, 2006.

6. Segmented information

The Company evaluates its performance in three operating segments: Digital Imaging, Electronic Payments Solutions, and Quality Assurance. The accounting policies for the segments are the same as those described in Note 1 to the Company's September 30, 2005 consolidated financial statements.

RDM CORPORATION
Notes to Consolidated Financial Statements
(Amounts in Canadian Dollars, In Thousands)

Operating Results by Segment

	Three Months Ended June 30, 2006				Three Months Ended June 30, 2005			
	Digital Imaging	Electronic Payments Solutions	Quality Assurance	Total	Digital Imaging	Electronic Payments Solutions	Quality Assurance	Total
Segment revenue	$ 4,156	$ 1,455	$ 576	$ 6,187	$ 1,843	$ 1,711	$ 579	$ 4,133
Segment operating earnings (loss)	(368)	594	182	408	(1,123)	1,096	114	87
Finance and corporate expenses				173				(1)
Net earnings				$ 235				$ 88

	Nine Months Ended June 30, 2006				Nine Months Ended June 30, 2005			
	Digital Imaging	Electronic Payments Solutions	Quality Assurance	Total	Digital Imaging	Electronic Payments Solutions	Quality Assurance	Total
Segment revenue	$ 11,215	$ 4,367	$ 1,512	$ 17,094	$ 6,661	$ 4,536	$ 1,998	$ 13,195
Segment operating earnings (loss)	(1,721)	2,117	308	704	(3,162)	2,920	551	309
Finance and corporate expenses				$ 269				$ 176
Net earnings				$ 435				$ 133