Rim Semiconductor CO
Form 10QSB
September 14, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JULY 31, 2006**

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ________ TO _________**

COMMISSION FILE NUMBER 0-21785

RIM SEMICONDUCTOR COMPANY

(Exact name of small business issuer as specified in its charter)

UTAH (State or other jurisdiction of incorporation or organization)	95-4545704 (I.R.S. Employer identification no.)
305 NE 102ND AVENUE, SUITE 105 PORTLAND, OREGON 97220 (Address of principal executive offices)	(503) 257-6700 (Issuer's telephone number, including area code)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.	Yes x No¨
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act)	Yes ¨ No x
The number of shares of the issuer's Common Stock, par value $.001 per share, outstanding as of September 11, 2006, was 346,396,890.	
Transitional Small Business Disclosure Format (Check one)	Yes ¨ No x

FORM 10-QSB

RIM SEMICONDUCTOR COMPANY

JULY 31, 2006

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PART I - FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
(Unaudited)

ASSETS

		July 31, 2006
Current Assets:		
Cash and cash equivalents	$	2,969,894
Other current assets		130,646
TOTAL CURRENT ASSETS		3,100,540
Property and equipment (net of accumulated depreciation of $3,545)		14,155
Technology license and capitalized software development fees (net of accumulated amortization of $531,692)		6,052,369
Deferred financing costs (net of accumulated amortization of $1,698,268)		1,843,550
Other assets		7,738
TOTAL ASSETS	$	11,018,352

LIABILITIES AND STOCKHOLDERS' DEFICIENCY

Current Liabilities:		
Convertible notes payable	$	500,000
Convertible debentures (net of debt discount of $3,881)		71,119
Derivative liabilities - warrants and options		24,450,714
Account payable and accrued expenses		1,057,025
TOTAL CURRENT LIABILITIES		26,078,858
Long-term portion of convertible debentures (net of debt discount of $4,507,897)		1,097,667
TOTAL LIABILITIES		27,176,525
Commitments, Contingencies and Other Matters		
Stockholders' Deficiency:		
Preferred stock - $0.01 par value; 15,000,000 shares authorized; -0- shares issued and outstanding		—
Common stock - $0.001 par value; 900,000,000 shares authorized; 332,484,557 shares issued and 331,984,703 outstanding		332,485

Treasury stock - 499,854 shares at cost		(7,498)
Additional paid-in capital		71,019,709
Unearned compensation		(1,497,171)
Accumulated deficit		(86,005,698)
TOTAL STOCKHOLDERS' DEFICIENCY		(16,158,173)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIENCY	$	11,018,352

See notes to condensed consolidated financial statements.

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RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	For the Nine Months Ended July 31, 2006	2005
REVENUES	$ 59,899	$ 26,558
OPERATING EXPENSES:		
Cost of sales	—	11,945
Impairment of film in distribution	—	1,009,777
Amortization of technology license and capitalized software development fees	531,692	—
Research and development expenses (including stock based compensation of $26,860 and $296,667, respectively)	255,821	303,720
Selling, general and administrative expenses(including stock based compensation of $1,501,569 and $998,963, respectively)	3,700,983	2,460,145
TOTAL OPERATING EXPENSES	4,488,496	3,785,587
OPERATING LOSS	(4,428,597)	(3,759,029)
OTHER EXPENSES (INCOME):		
Interest expense - net	9,275,907	1,183,318
Derivative loss (gain)	12,128,413	(1,799,103)
Amortization of deferred financing costs	1,017,659	120,934
Gain on forgiveness of liabilities	—	(99,369)
Gain on forgiveness of principal and interest on Zaiq Note	(1,169,820)	—
Gain on conversion of accrued expenses into convertible notes payable	—	(33,514)
Loss on exchange of notes payable into common stock	446,386	—
Gain on sale of property and equipment	—	(20,000)
Gain on exchange of Redeemable Series B Preferred Stock into common stock	—	(55,814)
Other	(3,000)	5,008
TOTAL OTHER EXPENSES (INCOME)	21,695,545	(698,540)
NET LOSS	$ (26,124,142)	$ (3,060,489)
BASIC AND DILUTED NET LOSS PER COMMON SHARE	$ (0.09)	$ (0.03)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	286,694,814	99,459,187

See notes to condensed consolidated financial statements.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	For the Three Months Ended July 31, 2006	2005
REVENUES	$ 1,025	$ 10,360
OPERATING EXPENSES:		
Impairment of film in distribution	—	1,009,777
Amortization of technology license and capitalized software development fees	216,460	—
Research and development expenses (including stock based compensation of $0 and $296,667, respectively)	119,888	296,667
Selling, general and administrative expenses (including stock based compensation of $517,859 and $110,033, respectively)	1,343,244	888,811
TOTAL OPERATING EXPENSES	1,679,592	2,195,255
OPERATING LOSS	(1,678,567)	(2,184,895)
OTHER EXPENSES (INCOME):		
Interest expense - net	1,378,138	543,672
Derivative loss (gain)	11,643,875	(1,799,103)
Amortization of deferred financing costs	448,840	67,825
Gain on forgiveness of liabilities	—	(99,369)
TOTAL OTHER EXPENSES (INCOME)	13,470,853	(1,286,975)
NET LOSS	$ (15,149,420)	$ (897,920)
BASIC AND DILUTED NET LOSS PER COMMON SHARE	$ (0.05)	$ (0.01)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	324,964,555	111,616,151

See notes to condensed consolidated financial statements.

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RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY
For The Nine Months Ended July 31, 2006
(Unaudited)

	Common Stock		Treasury Stock		Additional	Unearned	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-in Capital	Compensation	Deficit	Stockholders' Deficiency
Balance at October 31, 2005	184,901,320	$ 184,902	—	—	$ 61,359,999	$ (22,771)	$ (59,881,556)	$ 1,640,574
Repurchase of common stock for cash	—	—	(499,854)	$ (7,498)	—	—	—	(7,498)
Issuance of common stock under service and consulting agreements	12,624,752	12,625	—	—	2,219,592	(2,232,217)	—	—
Issuance of common stock for conversion of convertible debentures and accrued interest	110,654,584	110,654	—	—	2,361,299	—	—	2,471,953
Issuance of common stock for convertible notes payable and accrued interest	35,714	36	—	—	14,964	—	—	15,000
Issuance of common stock for notes payable and accrued interest	12,064,494	12,064	—	—	1,278,837	—	—	1,290,901
Issuance of common stock upon exercise of warrants	12,203,693	12,204	—	—	685,203	—	—	697,407
Stock options granted to key employees and advisory board member	—	—	—	—	1,010,835	(1,010,835)	—	—
Reclassification of derivative liability upon exercise of	—	—	—	—	1,141,769	—	—	1,141,769

warrants								
Reclassification of conversion option liability	—	—	—	—	947,211	—	—	947,211
Amortization of unearned compensation expense	—	—	—	—	—	1,768,652	—	1,768,652
Net loss	—	—	—	—	—	—	(26,124,142)	(26,124,142)
Balance at July 31, 2006	332,484,557	$ 332,485	(499,854)	$ (7,498)	$ 71,019,709	$ (1,497,171)	$ (86,005,698)	$ (16,158,173)

See notes to condensed consolidated financial statements.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Nine Months Ended July 31, 2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (26,124,142)	$ (3,060,489)
Adjustments to reconcile net loss to net cash used in operating activities:		
Consulting fees and other compensatory elements of stock issuances	1,528,429	1,295,630
Derivative loss (gain)	12,128,413	(1,799,103)
Issuance of common stock for below market issuance	—	5,008
Fair value of Investors' warrants in excess of debt discount	5,608,156	—
Loss on exchange of notes payable into common stock	446,386	—
Gain on forgiveness of liabilities	—	(99,369)
Gain on forgiveness of principal and interest on Zaiq Note	(1,169,820)	—
Gain on sale of property and equipment	—	(20,000)
Gain on exchange of Redeemable Series B Preferred Stock into common stock	—	(55,814)
Gain on conversion of accrued expenses into convertible notes payable	—	(33,514)
Amortization of deferred financing costs	1,017,659	120,934
Amortization of film in production costs	—	11,945
Amortization of debt discount on notes	3,290,683	941,531
Amortization of technology license and capitalized software development fees	531,692	—
Impairment of film in distribution	—	1,009,777
Depreciation	2,306	24,492
Change in Assets (Increase) Decrease:		
Other current assets	(96,615)	(24,035)
Other assets	2,486	(2,790)
Change in Liabilities Increase (Decrease):		
Accounts payable and accrued expenses	519,473	(66,248)
NET CASH USED IN OPERATING ACTIVITIES	(2,314,894)	(1,752,045)
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of capitalized software and development fees	(375,000)	—
Acquisition of property and equipment	(6,539)	(11,161)
NET CASH USED IN INVESTING ACTIVITIES	(381,539)	(11,161)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of common stock	—	835,100
Proceeds from exercise of warrants	697,407	—
Purchase of treasury stock	(7,498)	—
Proceeds from convertible debentures	6,000,000	3,500,000
Proceeds from notes payable	750,000	300,000
Capitalized financing costs	(742,450)	(422,010)
Repayments of notes payable	(944,291)	(1,120,048)
Repayments of convertible notes payable	(460,322)	(401,540)
NET CASH PROVIDED BY FINANCING ACTIVITIES	5,292,846	2,691,502

INCREASE IN CASH AND CASH EQUIVALENTS		2,596,413		928,296
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD		373,481		127,811
CASH AND CASH EQUIVALENTS - ENDING OF PERIOD	$	2,969,894	$	1,056,107

See notes to condensed consolidated financial statements.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For the Nine Months Ended July 31, 2006	2005
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 3,350	$ 203,539
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Common stock issued and for conversion of convertible debentures, convertible notes payable, notes payable and accrued interest	$ 3,777,854	$ 988,347
Common stock issued and issuable for consulting services (includes $458,061 of capitalized software development fees)	$ 2,423,611	$ —
Value assigned to warrants issued to holders of convertible debentures on the issuance date	$ 9,036,727	$ 2,000,000
Value assigned to warrants issued to placement agents on the issuance date	$ 1,792,452	$ 319,066
Value assigned to conversion option liability in connection with issuance of convertible debentures	$ 2,571,429	$ 1,500,000
Accounts payable and accrued expenses satisfied by issuance of common stock	$ —	$ 71,911
Common stock issued for accrued liquidated damages	$ —	$ 96,000
Accounts payable and accrued expenses converted to note payable	$ —	$ 55,251
Deferred compensation converted to convertible note payable	$ 212,450	$ 383,911
Reclassification of conversion option liability to equity	$ 947,211	$ —
Redeemable Series B Preferred Stock exchanged into notes payable	$ —	$ 2,392,000
Redeemable Series B Preferred Stock (recorded at $800,000) exchanged into common stock	$ —	$ 744,186
Stock options granted to key employees and advisory board member	$ 1,010,835	$ —
Reclassification of derivative liability upon exercise of warrants	$ 1,141,769	$ —

See notes to condensed consolidated financial statements.

**RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

NOTE 1 - PRINCIPLES OF CONSOLIDATION, BUSINESS AND CONTINUED OPERATIONS

The condensed consolidated financial statements include the accounts of Rim Semiconductor Company (formerly New Visual Corporation) and its wholly owned operating subsidiary, NV Entertainment, Inc. ("NV Entertainment" and collectively, the "Company"). Top Secret Productions, LLC is a 50% - owned subsidiary of NV Entertainment. All significant intercompany balances and transactions have been eliminated. The Company consolidates its 50% - owned subsidiary Top Secret Productions, LLC due to the Company's control of management and financial matters of such entity.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). In the opinion of management, the accompanying unaudited financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. These financial statements should be read in conjunction with the financial statements and notes related thereto included in the Annual Report on Form 10-KSB (Amendment No. 2) for the fiscal year ended October 31, 2005.

These results for the three months and nine months ended July 31, 2006 are not necessarily indicative of the results to be expected for the full fiscal year. The preparation of the consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Rim Semiconductor Company was incorporated under the laws of the State of Utah on December 5, 1985. The Company operates in two business segments, the production of motion pictures, films and videos ("Entertainment Segment") and the development of new semiconductor technologies ("Semiconductor Segment"). The Company's Entertainment Segment is dependent on future revenues from the Company's film "Step Into Liquid" ("Film"). The Semiconductor Segment is dependent on the Company's ability to successfully commercialize its developed technology, and has generated no revenues to date. The Company's first chipset was first made available to prospective customers for evaluation and testing during the three months ended January 31, 2006.

Through its subsidiary NV Entertainment, the Company has operating revenues for its Entertainment Segment, but may continue to report operating losses for this segment. The Semiconductor Segment will have no operating revenues until successful commercialization of its developed technology, but will continue to incur substantial operating expenses, capitalized costs and operating losses.

Historically, the Company has experienced significant recurring net operating losses as well as negative cash flows from operations. The Company's main source of liquidity has been equity and debt financing, which was used to fund historical losses from operating activities. Based on the Company's current cash position, the Company believes it has sufficient cash to meet its funding needs through at least August 2007. The Company plans to increase its expenses above the current level in order to realize its business plans.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

<u>Film In Distribution</u>

Statement of Position 00-2, Accounting by Producers or Distributors of Films (“SOP 00-2”) requires that film costs be capitalized and reported as a separate asset on the balance sheet. Film costs include all direct negative costs incurred in the production of a film, as well as allocations of production overhead and capitalized interest. Direct negative costs include cost of scenario, story, compensation of cast, directors, producers, writers, extras and staff, cost of set construction, wardrobe, accessories, sound synchronization, rental of facilities on location and post production costs. SOP 00-2 also requires that film costs be amortized and participation costs accrued, using the individual-film-forecast-computation method, which amortizes or accrues such costs in the same ratio that the current period actual revenue (numerator) bears to the estimated remaining unrecognized ultimate revenue as of the beginning of the fiscal year (denominator). The Company makes certain estimates and judgments of its future gross revenue to be received for the Film based on information received by its distributor, historical results and management’s knowledge of the industry.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Film In Distribution (Continued)

Revenue and cost forecasts are continually reviewed by management and revised when warranted by changing conditions. A change to the estimate of gross revenues for the Film may result in an increase or decrease to the percentage of amortization of capitalized film costs relative to a previous period.

In addition, SOP 00-2 requires that if an event or change in circumstances indicates that an entity should assess whether the fair value of a film is less than its unamortized film costs, then an entity should determine the fair value of the film and write-off to the statement of operations the amount by which the unamortized film costs exceeds the film's fair value.

As a result of impairment reviews during the years ended October 31, 2005 and 2004, the Company wrote down the carrying value attributed to the Film to $0. This resulted in an impairment of $1,009,777 being recognized during the three months and nine months ended July 31, 2005.

Revenue Recognition

The Company recognizes revenue from the sale of its semiconductor products when evidence of an arrangement exists, the sales price is determinable or fixed, legal title and risk of loss has passed to the customer, which is generally upon shipment of our products to our customers, and collection of the resulting receivable is probable. To date the Company has not recognized any revenues related to the sale of its semiconductor products.

The Company recognizes film revenue from the distribution of its feature film and related products when earned and reasonably estimable in accordance with SOP 00-2. The following conditions must be met in order to recognize revenue in accordance with SOP 00-2:

- persuasive evidence of a sale or licensing arrangement with a customer exists;
- the film is complete and, in accordance with the terms of the arrangement, has been delivered or is available for immediate and unconditional delivery;
- the license period of the arrangement has begun and the customer can begin its exploitation, exhibition or sale;
- the arrangement fee is fixed or determinable; and
- collection of the arrangement fee is reasonably assured.

Under a rights agreement with Lions Gate Entertainment ("LGE"), the domestic distributor for its Film entitled "Step Into Liquid," the Company shares with LGE in the profits of the Film after LGE recovers its marketing, distribution and other predefined costs and fees. The agreement provides for the payment of minimum guaranteed license fees, usually payable on delivery of the respective completed film, that are subject to further increase based on the actual distribution results in the respective territory.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Research and Development

Research and development costs are charged to expense as incurred. Amounts allocated to acquired-in-process research and development costs from business combinations are charged to earnings at the consummation of the acquisition.

Capitalized Software Development Costs

Capitalization of computer software development costs begins upon the establishment of technological feasibility. Technological feasibility for the Company's computer software is generally based upon achievement of a detail program design free of high-risk development issues and the completion of research and development on the product hardware in which it is to be used. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized computer software development costs require considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology.

Amortization of capitalized computer software development costs commences when the related products become available for general release to customers. Amortization is provided on a product-by-product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product bears to the total of current and anticipated future gross revenue for that product, or (b) the straight-line method over the remaining estimated economic life of the product. The estimated useful life of the Company's existing product is seven years.

The Company periodically performs reviews of the recoverability of such capitalized software development costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, the capitalized cost of each software product is then valued at the lower of its remaining unamortized costs or net realizable value.

No assurance can be given that such technology will receive market acceptance. Accordingly, it is possible that the carrying amount of the technology license may be reduced materially in the near future.

The Company had amortization expense of $216,460 and $531,692 for the three months and nine months ended July 31, 2006, respectively, related to its capitalized software development costs. There was no amortization expense for the three months and nine months ended July 31, 2005.

Loss Per Common Share

Basic loss per common share is computed based on weighted average shares outstanding and excludes any potential dilution. Diluted loss per share reflects the potential dilution from the exercise or conversion of all dilutive securities into common stock based on the average market price of common shares outstanding during the period. For the three months and nine months ended July 31, 2006 and 2005, no effect has been given to outstanding options, warrants, convertible notes payable, or convertible debentures in the diluted computation, as their effect would be anti-dilutive.

Stock-Based Compensation

On November 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123(R)”), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including stock options, based on estimated fair values. SFAS 123(R) supersedes the Company’s previous accounting under Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB 25”) for periods beginning on November 1, 2005. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (“SAB 107”) relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Stock-Based Compensation (Continued)

The Company early adopted SFAS 123(R) using the modified prospective transition method, as of November 1, 2005, the first day of the Company's fiscal year 2006. The Company's condensed consolidated financial statements as of and for the nine months ended July 31, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company's condensed consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R).

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's condensed consolidated statement of operations. Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Under the intrinsic value method, no stock-based compensation expense for employee stock options had been recognized in the Company's condensed consolidated statement of operations because the exercise price of the Company's stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

Stock-based compensation expense recognized in the Company's condensed consolidated statement of operations for the nine months ended July 31, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of October 31, 2005 based on the grant date fair value estimated in accordance with the pro-forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to October 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). The Company has continued to attribute the value of stock-based compensation to expense on the straight-line single option method.

Stock-based compensation expense recognized under SFAS 123(R) related to employee stock options was $205,240 and $653,079 for the three months and nine months ended July 31, 2006, respectively. Stock based-compensation expense for share-based payment awards granted prior to, but not yet vested as of October 31, 2005 based on the grant date fair value estimated in accordance with the pro-forma provisions of SFAS 123 was $0 and $247,057 for the three months and nine months ended July 31, 2006, respectively. Stock based-compensation expense recognized for non-employees under other accounting standards was $312,619 and $628,293 for the three months and nine months ended July 31, 2006, respectively.

As the closing price of common stock at July 31, 2005 was below the exercise price for certain options, previously recorded expense of $20,915 was reversed during the three months ended July 31, 2005. Accordingly, stock-based compensation expense related to employee stock options under other accounting standards for the three months and nine months ended July 31, 2005 was $(20,915) and $0, respectively. Stock based-compensation expense recognized for non-employees under other accounting standards was $130,948 and $546,463 for the three months and nine months ended July 31, 2005, respectively.

As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three months and nine months ended July 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company’s pro-forma information required under SFAS 123(R) for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Stock-Based Compensation (Continued)

Pro-Forma Information Under SFAS 123 for Periods Prior to Fiscal 2006

	For the Nine Months Ended July 31, 2005	For the Three Months Ended July 31, 2005
Net loss, as reported	$ (3,060,489)	$ (897,920)
Add: Stock-based employee compensation expense included in reported net loss	—	(20,915)
Less: Total stock-based employee compensation expense determined under the fair value-based method of all awards	(794,819)	(604,031)
Net loss, pro-forma	$ (3,855,308)	$ (1,522,866)
Basic and Diluted Net Loss per Common Share:		
As reported	$ (0.03)	$ (0.01)
Pro-forma	$ (0.04)	$ (0.01)

Impact of Recently Issued Accounting Standards

In June 2005, the FASB published Statement of Financial Accounting Standards No. 154, “Accounting Changes and Error Corrections” (“SFAS 154”). SFAS 154 establishes new standards on accounting for changes in accounting principles. Pursuant to the new rules, all such changes must be accounted for by retrospective application to the financial statements of prior periods unless it is impracticable to do so. SFAS 154 completely replaces Accounting Principles Bulletin No. 20 and SFAS 3, though it carries forward the guidance in those pronouncements with respect to accounting for changes in estimates, changes in the reporting entity, and the correction of errors. The requirements in SFAS 154 are effective for accounting changes made in fiscal years beginning after December 15, 2005. The Company will apply these requirements to any accounting changes after the implementation date.

In June 2006, the FASB ratified Emerging Issues Task Force (“EITF”) Issue No. 05-1, “Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer’s Exercise of a Call Option” (“EITF No. 05-1”), which indicates that no gain or loss should be recognized upon the conversion of an instrument that becomes convertible as a result of an issuer’s exercise of a call option pursuant to the original terms of the instrument. EITF No. 05-1 is effective for annual or interim periods beginning after June 28, 2006. The adoption of this pronouncement is not expected to have an impact on the Company’s consolidated financial position, results of operations, or cash flows.

In June 2005, the FASB ratified EITF Issue No. 05-2, “The Meaning of ‘Conventional Convertible Debt Instrument’ in EITF Issue No. 00-19, ‘Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock’” (“EITF No. 05-2”), which addresses when a convertible debt instrument should be considered “conventional” for the purpose of applying the guidance in EITF No. 00-19. EITF No. 05-2 also retained the exemption under EITF No. 00-19 for conventional convertible debt instruments and indicated that convertible preferred stock having a mandatory redemption date may qualify for the exemption provided under EITF No. 00-19 for conventional convertible debt if the instrument’s economic characteristics are more similar to debt than equity. EITF No. 05-2 is effective for new instruments entered into and instruments modified in periods beginning after June 29, 2005. The

Company has applied the requirements of EITF No. 05-2 since the required implementation date. The adoption of this pronouncement did not have an impact on the Company’s consolidated financial position, results of operations, or cash flows.

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NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impact of Recently Issued Accounting Standards (Continued)

EITF Issue No. 05-4 “The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF Issue No. 00-19, ‘Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock’” (“EITF No. 05-4”) addresses financial instruments, such as stock purchase warrants, which are accounted for under EITF No. 00-19 that may be issued at the same time and in contemplation of a registration rights agreement that includes a liquidated damages clause. The consensus of EITF No. 05-4 has not been finalized. The adoption of this pronouncement is not expected to have an impact on the Company’s consolidated financial position, results of operations, or cash flows.

In September 2005, the FASB ratified EITF Issue No. 05-7, “Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues” (“EITF No. 05-7”), which addresses whether a modification to a conversion option that changes its fair value affects the recognition of interest expense for the associated debt instrument after the modification and whether a borrower should recognize a beneficial conversion feature, not a debt extinguishment, if a debt modification increases the intrinsic value of the debt (for example, the modification reduces the conversion price of the debt). EITF No. 05-7 is effective for the first interim or annual reporting period beginning after December 15, 2005. The Company adopted EITF No. 05-7 as of the beginning of the Company’s interim reporting period that began on February 1, 2006. The adoption of this pronouncement did not have an impact on the Company’s consolidated financial position, results of operations, or cash flows.

In September 2005, the FASB ratified EITF Issue No. 05-8, “Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature” (“EITF No. 05-8”), which addresses the treatment of convertible debt issued with a beneficial conversion feature as a temporary difference under the guidance in SFAS 109. In addition, deferred taxes recognized for a temporary difference of debt with a beneficial conversion feature should be recognized as an adjustment of additional paid-in capital. Entities should apply the guidance in EITF No. 05-8 in the first interim or annual reporting period that begins after December 15, 2005. Its provisions should be applied retrospectively under the guidance in SFAS 154 to all convertible debt instruments with a beneficial conversion feature accounted for under the guidance in EITF No. 00-27 “Application of EITF Issue No. 98-5 ‘Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios.’” The Company has applied the requirements of EITF No. 05-8 to all previously existing convertible debt instruments with a beneficial conversion feature and will apply the requirements of EITF No. 05-8 for all new convertible debt instruments with a beneficial conversion feature. The adoption of this pronouncement for new convertible debt instruments with a beneficial conversion feature is not expected to have an impact on the Company’s consolidated financial position, results of operations or cash flows.

In February 2006, the FASB published Statement of Financial Accounting Standards No. 155, “Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140” (“SFAS 155”). SFAS 155 resolves issues addressed in SFAS 133 Implementation Issue No. D1, “Application of Statement 133 to Beneficial Interests in Securitized Financial Assets.” The requirements in SFAS 155 are effective for all financial instruments acquired or issued after the beginning of an entity’s first fiscal year that begins after September 15, 2006. The adoption of this pronouncement is not expected to have an impact on the Company’s consolidated financial position, results of operations, or cash flows.

NOTE 3 - FILM IN DISTRIBUTION

The Company recognized revenues of $1,025 and $59,899 for the three months and nine months ended July 31, 2006, respectively. The Company recognized revenues of $10,360 and $26,558 for the three months and nine months ended July 31, 2005, respectively. There was no amortization expense for the three months and nine months ended July 31, 2006. The Company had amortization expense of $0 and $11,945 for the three months and nine months ended July 31, 2005, respectively.

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RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
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(Unaudited)

NOTE 4 - DEFERRED FINANCING COSTS

As of July 31, 2006, deferred financing costs consisted of costs incurred and warrants issued in connection with the sale of $6,000,000 of 2006 Debentures, $3,500,000 of 2005 Debentures, $1,350,000 of 7% convertible debentures, and promissory notes:

Deferred financing costs	$ 3,541,818
Less: accumulated amortization	(1,698,268)
Deferred financing costs, net	$ 1,843,550

Costs incurred in connection with debt financings are capitalized as deferred financing costs and amortized over the term of the related debt. If any or all of the related debt is converted or repaid prior to its maturity date, a pro-rata share of the related deferred financing costs are written off and recorded as amortization expense in the period of the conversion or repayment in the consolidated statement of operations.

For the three months and nine months ended July 31, 2006, amortization of deferred financing costs was $448,840 and $1,017,659, respectively. For the three months and nine months ended July 31, 2005, amortization of deferred financing costs was $67,825 and $120,934, respectively.

NOTE 5 - EXCHANGE AGREEMENT

In April 2005, the Company entered into an Exchange Agreement (the "Exchange Agreement") with Zaiq Technologies, Inc. ("Zaiq"), pursuant to which the Company issued 4,651,163 shares of common stock with a value of $744,186 and a promissory note in the principal amount of $2,392,000 (the "Zaiq Note") in exchange for the surrender by Zaiq of 3,192 shares of Redeemable Series B Preferred Stock. The fair value of the common stock and promissory note on the closing date was determined to be less than the aggregate liquidation preference of the Redeemable Series B Preferred Stock and accordingly, a gain of $55,814 was recognized during the year ended October 31, 2005.

On December 19, 2005, the Company entered into a letter agreement with Zaiq, pursuant to which the Company agreed to repurchase from Zaiq for total consideration of $200,000 the following Zaiq assets: (i) 5,180,474 shares (the "Zaiq Shares") of the Company's common stock held of record by Zaiq, and (ii) the remaining principal balance of the Zaiq Note.

The Company had the right under the letter agreement to assign any or all of its purchase commitment, and assigned its right to purchase 4,680,620 of the Zaiq Shares to an unaffiliated third party that previously invested in the Company.

On December 20, 2005, the Company paid Zaiq an aggregate of $129,789, out of an advance on the note payable that was subsequently signed in January 2006 (see Note 8), to purchase the Zaiq Note and 499,854 Zaiq Shares. The Zaiq Shares repurchased by the Company have been accounted for as treasury stock, carried at cost, and reflected as a reduction to stockholders' equity. The remaining principal and accrued interest of $1,292,111 on the Zaiq Note has been canceled resulting in a gain of $1,169,820.

NOTE 6 - CONVERTIBLE NOTES PAYABLE

The Company entered into several convertible promissory note agreements with various trusts and individuals to fund the operations of the Company. The Company agreed to pay the principal and an additional amount equal to 50% of the principal on all notes below except for one note for $10,000, which accrues interest at the rate of 9% per annum.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
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(Unaudited)

NOTE 6 - CONVERTIBLE NOTES PAYABLE (CONTINUED)

The outstanding convertible notes are summarized below:

		At July 31, 2006
Note payable (1)	$	22,000
Notes payable (nine notes) (2)		468,000
Notes payable, 9% interest (3)		10,000
TOTAL	$	500,000

(1) The note was issued in October 2001 in the amount of $250,000, and due only when receipts received by the Company from its Top Secret Productions, LLC joint venture exceed $375,000. The note and any accrued and unpaid interest may be converted at any time, in whole or in part, into shares of common stock at a conversion price per share of $0.40. The Company made payments of $25,000 and $75,000 during the three months and nine months ended July 31, 2006, respectively.

(2) The notes were issued during the period from March 2002 through July 2003 in the aggregate amount of $478,000 and due only when receipts received by the Company from its Top Secret Productions, LLC joint venture exceed $2,250,000. The notes and any accrued and unpaid interest may be converted at any time, in whole or in part, into shares of common stock at conversion prices per share ranging from $0.33 to $1.00. Principal of $10,000 and accrued interest of $5,000 was converted into 35,714 shares of common stock during the three months ended April 30, 2006.

(3) The note was issued in July 2003 in the amount of $10,000, and due only when receipts received by the Company from its Top Secret Productions, LLC joint venture exceed $750,000. The note and any accrued and unpaid interest may be converted at any time, in whole or in part, into shares of common stock at a conversion price per share of $0.60.

NOTE 7 - CONVERTIBLE DEBENTURES

2006 Debentures

On March 10, 2006, the Company raised gross proceeds of $6.0 million from a private placement to 17 institutional and individual investors (the “Investors”) of its two-year 7% Senior Secured Convertible Debentures (the “2006 Debentures”). Of this amount, $3.0 million was delivered by the Company to a security agent, acting on behalf of the Investors (the “Security Deposit”), to secure certain obligations of the Company to the Investors if the Company failed to file an amendment, with the approval of the Company’s shareholders, to its charter documents to reflect the increase in the Company’s authorized common stock from 500 million to 900 million shares (the “Authorized Share Increase”). The Company’s shareholders approved the Authorized Share Increase on April 18, 2006 and the $3.0 million Security Deposit was released to the Company.

In connection with the issuance of the 2006 Debentures, the Company issued to the Investors warrants to purchase 70,955,548 shares of the Company's common stock at an exercise price of $0.15 per share valued at $9,036,727 on the issuance date (subject to adjustments for stock splits, stock dividends, recapitalizations, mergers, spin-offs, and certain other transactions). The warrants are exercisable until the last day of the month in which the third anniversary of the effective date of the registration statement registering the shares underlying the warrants occurs (August 31, 2009).

The Company received net proceeds of approximately $4.5 million from the proceeds of the 2006 Debentures, after the payment of offering related fees and expenses and after the repayment in full of bridge loans made in December 2005 and January 2006, in the aggregate amount of $810,000.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 7 - CONVERTIBLE DEBENTURES (CONTINUED)

2006 Debentures (Continued)

The 2006 Debentures are convertible into shares of common stock at a conversion price for any such conversion equal to the lower of (x) 70% of the volume weighted average price ("VWAP") of the common stock for the 20 days ending on the trading day immediately preceding the conversion date or (y) if the Company enters into certain financing transactions, the lowest purchase price or conversion price applicable to that transaction. The conversion price is subject to adjustment.

Interest on the 2006 Debentures accrues at the rate of 7% per annum, payable upon conversion, or semi-annually (June 30 and December 31 of each year) or upon maturity, whichever occurs first, and will continue to accrue until the 2006 Debentures are fully converted and/or paid in full. Interest is payable, at the option of the Company, either (i) in cash, or (ii) in shares of common stock at the then applicable conversion price.

To secure the Company's obligations under the 2006 Debentures, the Company has granted a security interest in substantially all of its assets, including without limitation, its intellectual property, in favor of the Investors. The security interest terminates upon the earlier of (i) the date on which less than one-fourth of the original principal amount of the 2006 Debentures issued on the Closing Date are outstanding or (ii) payment or satisfaction of all of the Company's obligations under the related securities purchase agreement.

The Company agreed to include the shares of common stock issuable upon conversion of the 2006 Debentures and exercise of the related warrants issued to investors and the placement agent in a registration statement filed by the Company with the Securities and Exchange Commission (the "SEC"). Since the registration statement was not declared effective by the SEC by June 23, 2006, the Company is obligated to pay liquidated damages to the holders of the 2006 Debentures. As of July 31, 2006, accrued liquidated damages totaled $152,000. A registration statement covering the common stock issuable upon conversion of the 2006 Debentures and the related warrants issued to investors and the placement agent was declared effective by the SEC on August 16, 2006. As of August 16, 2006, accrued liquidated damages totaled $212,000. At their option, the holders of the 2006 Debentures are entitled to be paid such amount in cash or shares of common stock at a per share rate equal to the effective conversion price of the debentures.

In connection with the placement of the 2006 Debentures, a placement agent received a placement agent fee equal to (i) 10% of the aggregate purchase price (i.e., $600,000), (ii) 10% of the proceeds realized in the future from exercise of warrants issued to the Investors, (iii) warrants to purchase an aggregate of 7,095,556 shares of common stock having an initial exercise price equal to $0.1693 per share valued at $888,779 on the issuance date, and (iv) warrants to purchase an aggregate of 7,095,556 shares of common stock having an initial exercise price equal to $0.15 per share valued at $903,673 on the issuance date. The exercise price of the placement agent warrants is subject to adjustments for stock splits, stock dividends, recapitalizations, mergers, spin-offs, and certain other transactions.

The aggregate fair value of the placement agent's warrants of $1,792,452 on the issuance date was recorded as a deferred financing cost and is being charged to interest expense over the term of the 2006 Debentures.

The gross proceeds of $6,000,000 are recorded as a liability net of a debt discount of $6,000,000 consisting of an allocation of the fair values attributed to the Investors' warrants and to the embedded conversion feature in accordance with EITF issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a

Company's Own Stock." The debt discount consisted of a $3,428,571 value related to the Investors' warrants and a value attributed to the embedded conversion feature of $2,571,429. The debt discount was first allocated to the embedded conversion feature based on its fair value. After reducing the gross proceeds by the value allocated to the embedded conversion feature, the remaining unallocated debt discount of $3,428,571 was allocated to the Investors' warrants. The excess of the fair value of the Investors' warrants above the debt discount allocated to the Investors' warrants was $5,608,156 and was recorded as interest expense.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 7 - CONVERTIBLE DEBENTURES (CONTINUED)

2006 Debentures (Continued)

In accordance with EITF No. 00-19, due to certain factors, including an uncapped liquidated damages provision in the registration rights agreement and an indeterminate amount of shares to be issued upon conversion of the debentures, the Company separately values and accounts for the embedded conversion feature related to the 2006 Debentures, the Investors' warrants, the placement agent's warrants, and the registration rights as derivative liabilities. Accordingly, these derivative liabilities are measured at fair value with changes in fair value reported in earnings as long as they remain classified as liabilities. The Company reassesses the classification at each balance sheet date. If the classification required under EITF No. 00-19 changes as a result of events during the period, the contract is reclassified as of the date of the event that caused the reclassification.

During the three months ended July 31, 2006, $400,000 of principal amount of 2006 Debentures plus accrued interest of $129,567 were converted into 5,647,147 shares of common stock.

As of July 31, 2006, the conversion option liability of $2,571,429 had been reduced to $2,400,000 as a result of conversions of the 2006 Debentures. Since the issuance of the 2006 Debentures, an aggregate of $171,429 has been reflected as a reclassification to stockholders' equity.

A loss on the change in fair value of these derivative liabilities of $9,315,408 and $6,666,740 was recognized during the three months and nine months ended July 31, 2006, respectively.

Included in interest expense for the three months and nine months ended July 31, 2006 is $1,076,881 and $1,495,486, respectively, related to the amortization of the debt discount on these debentures.

The 2006 Debentures are summarized below as of July 31, 2006:

	Outstanding Principal Amount	Unamortized Debt Discount	Net Carrying Value
Long-term portion	$ 5,600,000	$ 4,504,514	$ 1,095,486

2005 Debentures

On May 26, 2005, the Company completed a private placement to certain individual and institutional investors of $3,500,000 in principal amount of its three-year 7% Senior Secured Convertible Debentures (the "2005 Debentures"). All principal is due and payable on May 26, 2008. The 2005 Debentures are convertible into shares of common stock at a conversion price equal to the lower of (x) 70% of the 5 day volume weighted average price of the Company's common stock immediately prior to conversion or (y) if the Company entered into certain financing transactions subsequent to the closing date, the lowest purchase price or conversion price applicable to that transaction.

In connection with the issuance of the 2005 Debentures, the Company issued to the purchasers thereof warrants (the "Investor Warrants") to purchase 33,936,650 shares of common stock valued at $2,000,000 on the issuance date, with warrants for 11,312,220 shares being exercisable through August 31, 2006 at a per share exercise price of $0.1547 and warrants for 22,624,430 shares being exercisable through August 31, 2008 at a per share exercise price of $0.3094.

In connection with the issuance of the 2005 Debentures, the Company also issued to a placement agent warrants to purchase up to 5,656,108 shares of Common Stock (the "Compensation Warrants") valued at $319,066 on the issuance date. This amount was recorded as a deferred financing cost and is being charged to interest expense over the term of the 2005 Debentures. Warrants to purchase up to 2,262,443 shares were exercisable through August 31, 2008 at a per share exercise price of $0.3094. Warrants to purchase up to 2,262,443 shares were exercisable through May 31, 2008 at a per share exercise price of $0.1547. Warrants to purchase up to 1,131,222 shares were exercisable through August 31, 2006 at a per share exercise price of $0.1547. All of the Compensation Warrants were exercised during the nine months ended July 31, 2006.

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NOTE 7 - CONVERTIBLE DEBENTURES (CONTINUED)

2005 Debentures (Continued)

The gross proceeds of $3,500,000 are recorded as a liability net of a debt discount of $3,500,000. The debt discount consisted of a $2,000,000 value related to the Investor Warrants and a $1,500,000 value related to the embedded conversion feature in accordance with EITF issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock." Due to certain factors, including an uncapped liquidated damages provision in the registration rights agreement and an indeterminate amount of shares to be issued upon conversion of the debentures, the Company separately values and accounts for the embedded conversion feature related to the 2005 Debentures, the Investors' Warrants, the Compensation Warrants, and the registration rights as derivative liabilities. Accordingly, these derivative liabilities are measured at fair value with changes in fair value reported in earnings as long as they remain classified as liabilities. The Company reassesses the classification at each balance sheet date. If the classification required under EITF No. 00-19 changes as a result of events during the period, the contract is reclassified as of the date of the event that caused the reclassification. Due to various factors, including substantial conversions of the 2005 Debentures and the registration statement registering the 2005 Debentures becoming effective on August 1, 2005, the value of the registration rights was deemed to be de minimus.

As of July 31, 2006, the conversion option liability of $1,500,000 had been reduced to $2,385 as a result of conversions of the 2005 Debentures. Since the issuance of the 2005 Debentures, an aggregate of $1,497,615 has been reclassified from conversion option liability to stockholders' equity.

During the nine months ended July 31, 2006, upon the exercise by holders of the Investor and Compensation Warrants, of warrants to purchase an aggregate of 12,203,693 shares, the Company reassessed the classification of the exercised warrants and reclassified the fair value of the exercised warrants of $1,141,769 from current liabilities to stockholders' equity.

A loss on the change in fair value of these derivative liabilities of $1,058,056 and $4,191,262 was recognized during the three months and nine months ended July 31, 2006, respectively.

On February 21, 2006, the Company and certain holders of Investor and Compensation Warrants entered into an amendment (the "Warrant Amendment") to the terms of their warrants. Pursuant to the Warrant Amendment, the Company and certain holders of the Investor and Compensation Warrants agreed to temporarily reduce the exercise price of the Investor and Compensation Warrants to $0.05 per share from February 21, 2006 until March 10, 2006 (the "New Price Exercise Period"). The warrant holders that are parties to the Warrant Amendment were permitted, but not required to, exercise all or any portion of their Investor and Compensation Warrants at a per share price of $0.05 at any time during the New Price Exercise Period, but could not do so by means of a cashless exercise. This reduction in the exercise price of the Investor and Compensation Warrants expired on March 10, 2006. During the New Price Exercise Period, holders of the Investor and Compensation Warrants exercised warrants to purchase 11,370,624 shares of common stock at the reduced exercise price of $0.05 per share, resulting in gross proceeds to the Company of $568,531. Except as expressly provided in the Warrant Amendment, the terms and conditions of the Investor and Compensation Warrants and any related registration rights agreement shall be unchanged and remain in full force and effect. In addition, the warrant holders agreed to waive any claims arising out of or relating to the failure, if any, to have available registered Warrant Shares, as defined in the Investor and Compensation Warrants, prior to June 23, 2006.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
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NOTE 7 - CONVERTIBLE DEBENTURES (CONTINUED)

2005 Debentures (Continued)

The Company agreed to include the shares of common stock issuable upon the exercise of each Investor or Compensation Warrant (whether or not pursuant to the terms of the Warrant Amendment) in a registration statement to be filed by the Company with the SEC. The common stock underlying the Investor and Compensation Warrants were included in the registration statement declared effective by the SEC on August 16, 2006.

To secure the Company's obligations under the 2005 Debentures, the Company granted a security interest in substantially all of its assets, including without limitation, its intellectual property, in favor of the investors under the terms and conditions of a Security Interest Agreement dated as of the date of the 2005 Debentures. The security interest terminates upon the earlier of (i) the date on which less than one-third of the original principal amount of the 2005 Debentures issued on the closing date are outstanding or (ii) payment or satisfaction of all of the Company's obligations under the loan agreement. In January 2006, condition (i) was met and the security interest terminated.

During the three months ended January 31, 2006, $1,310,724 of principal amount of 2005 Debentures plus accrued interest of $69,777 were converted into 81,262,199 shares of common stock. During the three months ended April 30, 2006, $464,423 of principal amount of 2005 Debentures plus accrued interest of $2,401 were converted into 22,908,266 shares of common stock. During the three months ended July 31, 2006, $35,000 of principal amount of 2005 Debentures plus accrued interest of $1,087 were converted into 443,814 shares of common stock.

Included in interest expense for the three months and nine months ended July 31, 2006 is $24,643 and $1,550,586, respectively, related to the amortization of the debt discount on these debentures.

The 2005 Debentures are summarized below as of July 31, 2006:

	Outstanding Principal Amount	Unamortized Debt Discount	Net Carrying Value
Long-term portion	$ 5,564	$ 3,383	$ 2,181

7% Debentures

In December 2003, April 2004 and May 2004, the Company completed a private placement to certain private and institutional investors of $1,350,000 in principal amount of its three-year 7% Convertible Debentures (the "7% Debentures").

During the three months ended July 31, 2006, $50,000 of principal amount plus accrued interest of $8,974 were converted into 393,158 shares of common stock at a conversion price of $0.15.

During the three months ended January 31, 2005, $199,450 of principal amount plus accrued interest of $12,264 were converted into 1,411,428 shares of common stock at a conversion price of $0.15. During the three months ended April 30, 2005, $383,050 of principal plus accrued interest of $28,212 were converted into 2,741,747 shares of common stock at a conversion price of $0.15. During the three months ended July 31, 2005, $325,000 of principal amount plus accrued interest of $32,860 were converted into 2,385,804 shares of common stock at a conversion price of $0.15.

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NOTE 7 - CONVERTIBLE DEBENTURES (CONTINUED)

7% Debentures (continued)

Included in interest expense for the three months and nine months ended July 31, 2006, is $20,255 and $43,736, respectively, related to the amortization of the debt discount on these debentures.

The 7% Debentures are summarized below as of July 31, 2006:

	Outstanding Principal Amount	Unamortized Debt Discount	Net Carrying Value
Current portion	$ 75,000	$ 3,881	$ 71,119

The remaining 7% Debentures outstanding at July 31, 2006 were originally issued in December 2003 and are due and payable in December 2006.

NOTE 8 - NOTES PAYABLE

The Company does not currently have any outstanding notes payable. During the nine months ended July 31, 2006, the Company recognized losses as a result of the conversion of several notes payable into common stock and also repaid several notes payable, as further described below.

In February 2006, the Company issued 5,304,253 shares of restricted common stock in exchange for the return and cancellation of the outstanding principal of $256,886 and interest of $114,412 on five, unsecured individual notes payable, each with identical terms and bearing 6% interest. As the conversion rate of $0.07 was below the closing price of the common stock on the conversion date, a loss of $196,257 was recognized during the three months ended April 30, 2006.

Outstanding principal of $39,973 and interest of $110,027 was paid in June 2005 on an unsecured note payable bearing 10% interest from the proceeds of the private placement of the 2005 Debentures. In February 2006, the Company issued 6,760,241 shares of restricted common stock in exchange for the return and cancellation of the outstanding principal of $443,251 and interest of $29,766 on this note. As the conversion rate of $0.07 was below the closing price of the common stock on the conversion date, a loss of $250,129 was recognized during the three months ended April 30, 2006.

On March 26, 2004, the Company entered into a loan agreement, pursuant to which the Company borrowed $12,000 from the lender. In April 2006, the outstanding principal of $12,000 and interest of $1,217 were repaid.

In April 2005, the Company issued a promissory note in connection with the cancellation of the Redeemable Series B Preferred Stock which bears interest at the rate of 7% per annum. In December 2005, the Company entered into an agreement to repay a portion of the outstanding principal and accrued interest on the promissory note with the remaining principal balance and accrued interest being forgiven. See Note 5 for further details.

In December 2005 and January 2006, the Company entered into loan agreements with a third party pursuant to which the Company borrowed $750,000 from the lender. An amount equal to 108% of the principal amount ($810,000) of the loans is due and payable on the earlier of May 25, 2006 or the date the Company effects a financing transaction or series of transactions resulting in gross proceeds to the Company of at least $2,000,000. The difference between the gross proceeds and amount due at maturity is shown as a discount that is amortized as interest expense over the life of the loans. The Company issued to the lender warrants to purchase 7,500,000 shares of its Common Stock at an exercise price of $0.10 per share. The fair value of the warrants was $120,000 and was shown as a debt discount and amortized as interest expense over the life of the loans. In connection with the loans, the Company granted a security interest in all of its assets. The Company received net proceeds of $672,470 following the payment of due diligence fees and transaction fees and transaction related fees and expenses. These transaction related fees were recorded as deferred financing costs. For the three months ended January 31, 2006, amortization of debt discount on this loan was $10,413.

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NOTE 8 - NOTES PAYABLE (CONTINUED)

In March 2006, 108% of the principal amount ($810,000) was repaid and the security interest was released. All unamortized debt discount and deferred financing costs were written off during the three months ended April 30, 2006 in connection with the repayment of the loan.

NOTE 9 - STOCKHOLDERS' EQUITY

Common Stock

During the nine months ended July 31, 2006, the Company:

- issued 110,654,584 shares of common stock for conversion of convertible debentures with a principal amount of $2,260,147 and accrued interest of $211,806;
- repurchased 499,854 shares of common stock for $7,498 from Zaiq;
- issued 35,714 shares of common stock for conversion of convertible notes payable with a principal amount of $10,000 and accrued interest of $5,000;
- issued 12,064,494 shares of common stock valued at $1,290,901 in exchange for the return and cancellation of notes payable with a principal amount of $700,337 and accrued interest of $144,178;
- issued 12,203,693 shares of common stock upon exercise of warrants resulting in gross proceeds of $697,407; and
- issued 12,624,752 shares of restricted common stock to consultants for services valued at $2,232,217.

Stock Option Plans

On November 1, 2005, the Company early adopted SFAS 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company's employees and directors including employee stock options based on estimated fair values.

Upon adoption of SFAS 123(R), the Company continued to estimate the value of stock options on the date of grant using the Black-Scholes model and the assumptions noted in the table below. Prior to the adoption of SFAS 123(R), the value of each stock option was also estimated on the date of grant using the Black-Scholes model for the purpose of the pro-forma financial information in accordance with SFAS 123.

The expected volatility is based on a blend of the Company's industry peer group and the Company's historical volatility. The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of the Company's stock options. The dividend yield assumption is based on the Company's history and expectation of dividend payouts. The expected life of stock options represents the Company's historical experience with regards to the exercise behavior of its option holders and the contractual term of the options.

As stock-based compensation expense recognized in the condensed consolidated statement of operations for the three months and nine months ended July 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company’s pro-forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

RIM SEMICONDUCTOR COMPANY AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 9 - STOCKHOLDERS' EQUITY (CONTINUED)

Stock Option Plans (Continued)

The weighted-average estimated fair value of stock options granted during the nine months ended July 31, 2006 was $0.03 per share using the Black-Scholes model with the following assumptions:

Expected volatility	145%
Risk-free interest rate	4.4%
Expected dividends	0.0%
Expected life	10 years

A summary of option activity as of July 31, 2006 and changes during the period then ended is as follows:

	Under the Plans	Weighted Average Exercise Price	Aggregate Intrinsic Value	Outside the Plans	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at October 31, 2005	993,750	$ 0.97		15,900,000	$ 0.25	
Options granted:						
Under the Plans	1,000,000	$ 0.17		—	—	
Outside the Plans	—	—		26,600,000	$ 0.03	
Options expired						