

LML PAYMENT SYSTEMS INC  
Form 10-Q  
February 13, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**Form 10-Q**

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

For the Quarterly Period Ended December 31, 2003

OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-13959

LML PAYMENT SYSTEMS INC.  
(Exact name of registrant as specified in its charter)

Yukon Territory	980-20-9289
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1680-1140 West Pender Street  
Vancouver, British Columbia  
Canada V6E 4G1

(Address of principal executive offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: **(604) 689-4440**

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

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

The number of shares of the registrant's Common Stock outstanding as of January 23, 2004, was 19,615,561.

LML PAYMENT SYSTEMS INC.  
FORM 10-Q  
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2003

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In this Quarterly Report on Form 10-Q, unless otherwise indicated, all dollar amounts are expressed in United States Dollars.

PART I.

FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

LML PAYMENT SYSTEMS INC.

CONSOLIDATED BALANCE SHEETS

(In U.S. Dollars)

March  
31,  
2003  
\$

ASSETS

Intangibles

Intangibles (Note 2)

less allowances of \$109,916 and \$60,815, respectively

or Sale, net

Note 3)

LIABILITIES

on

capital lease obligations (Note 3)

ferred revenue

ties

ions (Note 3)

SHAREHOLDERS' EQUITY

ock, \$1.00 CDN par value, 150,000,000  
suable in series, none issued or

ock, \$1.00 CDN par value, 150,000,000  
suable in series, none issued or

par value, 100,000,000 shares  
61 and 19,593,061 shares issued and  
vely

Equity

ES AND SHAREHOLDERS' EQUITY



See accompanying notes to the consolidated financial statements.

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LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT  
(In U.S. Dollars, except share data)

(Unaudited)

Three	Nine
Months	Months
Ended	Ended
December	December
31	31

REVENUE

COSTS AND EXPENSES

Cost of operations

Sales, general and administrative

Amortization and depreciation

Other expenses

LOSS FROM CONTINUING OPERATIONS BEFORE INTEREST INCOME AND INCOME TAXES

Interest income, net

LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES

State income taxes

LOSS FROM CONTINUING OPERATIONS

Discontinued operations (Note 5)



NET LOSS

DEFICIT, beginning of period

Change in accounting policy

DEFICIT, end of period

LOSS PER SHARE

Basic loss per share

Loss from continuing operations

Net loss

Diluted loss per share

Loss from continuing operations

Net loss

WEIGHTED AVERAGE SHARES OUTSTANDING

Basic

Diluted

See accompanying notes to the consolidated financial statements.

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LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In U.S. Dollars)

(Unaudited)

ThreeNine  
MonthMonths  
EndedEnded  
Decemberember  
31 31

Operating Activities:

Loss from continuing operations



Adjustments to reconcile loss from continuing operations to net cash (used in) provided by operating activities

Provision for losses on accounts receivable

Amortization and depreciation

Other

Changes in operating assets and liabilities

Restricted Cash

Accounts receivable

Prepaid expenses

Accounts payable and accrued liabilities

Other assets

Deferred revenue

Net cash (used in) provided by operating activities of continuing operations

Investing Activities:

Short term investments

Capital asset expenditures

Patents

Net cash used in investing activities of continuing operations

Financing Activities:

Payments on capital leases

Proceeds from exercise of stock options

Net cash (used in) provided by financing activities of continuing operations

Net cash (used in) provided by continuing operations



Net cash (used in) provided by discontinued operations

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

Cash and cash equivalents, beginning of period

Cash and cash equivalents, end of period

See accompanying notes to the consolidated financial statements.

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)

1. Basis of Presentation

The consolidated balance sheet as of December 31, 2003 and the consolidated statements of operations and deficit and cash flows for the three months and nine months ended December 31, 2003 and 2002 of LML Payment Systems Inc. and its subsidiaries (collectively, the "Corporation") are unaudited. The Corporation's consolidated balance sheet as of March 31, 2003, was derived from its audited consolidated financial statements. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements are included herein. Other than those discussed in the notes below, such adjustments consist only of normal recurring items. Interim results are not necessarily indicative of results for a full year. The Corporation's consolidated financial statements and notes are presented in accordance with generally accepted accounting principles in Canada for interim financial information and in accordance with the instructions for Form 10-Q and Article 10 of Regulation S-X, and do not contain certain information included in the Corporation's consolidated audited annual financial statements and notes. The consolidated financial statements and notes appearing in this report should be read in conjunction with the Corporation's consolidated audited financial statements and related notes thereto, together with management's discussion and analysis of financial condition and results of operations, contained in the Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2003, as filed with the Securities and Exchange Commission on June 27, 2003 (file no. 0-13959). Certain of the prior period financial statement amounts have been reclassified to conform to the current period presentation.

The significant accounting policies used in these interim financial statements are consistent with those used in preparing the Corporation's latest annual financial statements for the year ended March 31, 2003 except for the one noted below.

Significant Accounting Policies

## Revenue Recognition

In accordance with SAB 101 "Revenue Recognition" and further guidance provided by CICA EIC-142 and EITF-00-21 "Revenue Arrangements with Multiple Deliverables", the Corporation, with respect to the licensing of its patented intellectual property, accounts for revenue received from each deliverable as a separate unit of accounting using the residual method. Revenue is recognized for each deliverable when all significant performance conditions required to earn the revenue have been met and when the amount is reasonably determinable.

## 2. Short term investments

In October, 2003 the Corporation invested cash in a term deposit in the amount of \$183,561, maturing April 19, 2004 earning interest at the rate of 0.625% per annum.

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## 3. Capital lease obligations

December	March
31, 2003	31,
\$	2003
	\$

Obligations under capital lease agreement

Less current portion

In October 2003, the Corporation entered into a lease agreement with IBM Credit Corporation to finance an equipment purchase of \$104,140. Lease payments are due on the last day of each month under the lease terms of thirty-six (36) months. Title to the equipment will transfer to the Corporation at the expiration of the lease. Accordingly these amounts have been recorded as a capital lease.

representing interest (8%)

ance

The lease is collateralized by the equipment under capital lease.

4. Stock-based compensation

CICA Handbook section 3870 Stock-based Compensation and Other Stock-based Payments ("CICA 3870"), encourages, but does not require, corporations to record compensation cost for stock-based employee compensation plans based on the fair value of options granted. We have elected to continue to account for stock-based compensation using the intrinsic value method and to provide disclosures of the pro forma effects had we recorded compensation expense under the fair value method. During the nine months ended December 31, 2003, there were 40,000 stock options granted. The pro forma compensation expense recorded during the three months and nine months ended December 31, 2003 and 2002 represents the amortization of previously issued stock options as well as the stock options granted during the three and nine months ended December 31, 2003 and 2002. These options are amortized to pro forma compensation expense as the options vest.

Three	Nine
Month	Months
Ended	Ended
December	December
31	31

2003  
\$

2002  
\$

2003  
\$

2002  
\$

Net loss

As reported

Compensation cost

Pro forma

Basic and diluted net loss per share

As reported

Pro forma

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Fair value of options granted are estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions for the three months and nine months ended December 31, 2003 and 2002:



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Risk free interest rate of 4% for the three months and nine months ended December 31, 2003 and 2002;

Expected volatility of 104% for three months and nine months ended December 31, 2003 and 2002;

Expected life of the options of 4 years for the three months and nine months ended December 31, 2003 and 2002;

No dividend yields.

5. Discontinued operations

On June 18, 2003 the Corporation, through its subsidiary LHTW Properties Inc. sold its real property located in Wildwood, Florida. The decision to discontinue operations of this business segment, previously reported under the Residential Real Estate Operations segment, resulted from an opportunity to sell the property and consequently remove a business segment no longer consistent with the Corporation's business strategy. The Corporation received gross proceeds of \$2.4 million, less selling costs of \$185,113, for net proceeds of \$2,214,887. The Corporation has recorded a gain on the sale of \$625,042 during the nine months ended December 31, 2003. There are no expected tax consequences to the Corporation as there are previously existing non-capital losses which the Corporation can apply this gain against. The results of these discontinued operations have been reclassified in the statements of operations and deficit and cash flows for the three months and nine months ended December 31, 2003 and 2002. The results of operations of the Residential Real Estate Operations segment are as follows:

Consolidated Statements of Operations	Three Months ended December 31		Nine Months ended December 31	
	2003	2002	2003	2002
	\$	\$	\$	\$
Revenue				

Net loss from discontinued operations

Net gain from sale of property

Discontinued operations

6. Reconciliation of United States to Canadian Generally Accepted Accounting Principles

These financial statements are prepared using Canadian generally accepted accounting principles ("CDN GAAP") which do not differ materially from United States generally accepted accounting principles ("U.S. GAAP") with respect to the accounting policies and disclosures in these financial statements except as set out below and as more fully described in the Corporation's annual audited consolidated financial statements for the fiscal year ended March 31, 2003:

- a. Under U.S. GAAP, the Corporation could not effect the reduction in deficit of \$22,901,744 (performed in fiscal 2001 and disclosed in the Corporation's Form 10-K for the fiscal year ended March 31, 2001) by reducing the stated capital of the shares of the Corporation's common stock.

Under U.S. GAAP there are no adjustments that resulted in changes to the Consolidated Statements of Operations and Deficit,

Consolidated Statements of Cash Flows or the Consolidated Balance Sheets of the Corporation.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Unless the context otherwise requires, references in this report on Form 10-Q to the "Corporation", "LML", "we", "us" or "our" refer to LML Payment Systems Inc. and its direct and indirect subsidiaries. LML Payment Systems Inc.'s direct subsidiaries include LML Corp., Legacy Promotions Inc. and LHTW Properties Inc. LML Corp.'s subsidiaries are LML Patent Corp., and LML Payment Systems Corp. Unless otherwise specified herein, all references herein to dollars or "\$" are to U.S. Dollars.

The following discussion and analysis should be read in conjunction with the consolidated audited financial statements and related notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended March 31, 2003, filed with the Securities and Exchange Commission on June 27, 2003 (file no. 0-13959). We believe that all necessary adjustments (consisting only of normal recurring adjustments) have been included in the amounts stated below to present fairly the following quarterly information. Quarterly operating results have varied significantly in the past and can be expected to vary in the future. Results of operations for any particular quarter are not necessarily indicative of results of operations for a full year.

### Forward Looking Information

All statements other than statements of historical fact contained herein are forward-looking statements. Forward-looking statements generally are accompanied by words such as "anticipate," "believe," "estimate," "intend," "project," "potential" or "expect" or similar statements. The forward-looking statements were prepared on the basis of certain assumptions which relate, among other things, to the demand for and cost of marketing our services, the volume and total value of transactions processed by merchants utilizing our services, the technological adaptation of electronic check conversion end-users, the renewal of material contracts in our business, our ability to anticipate and respond to technological changes, particularly with respect to financial payments and e-commerce, in a highly competitive industry characterized by rapid technological change and rapid rates of product obsolescence, our ability to develop and market new product enhancements and new products and services that respond to technological change or evolving industry standards, no unanticipated developments relating to previously disclosed lawsuits against us, and the cost of protecting our intellectual property. Even if the assumptions on which the forward-looking statements are based prove accurate and appropriate, the actual results of our operations in the future may vary widely due to technological change, increased competition, new government regulation or intervention in the industry, general economic conditions, other risks described in our filings with the Securities and Exchange Commission. Accordingly, the actual results of our operations in the future may vary widely from the forward-looking statements included herein. All forward-looking statements included herein are expressly qualified in their entirety by the cautionary statements in this paragraph.

### Overview

LML Payment Systems Inc. is a financial payment processor that provides consumer financial payment processing solutions to retailers and other clients in the United States. Our financial payment processing solutions include traditional check recovery, electronic check re-presentment, electronic check authorization and electronic check conversion. We also provide electronic fund transfer switching services to certain segments of the retail industry. We focus on providing our services to supermarkets, grocery stores, multi-lane retailers, convenience stores and other national, regional and local retailers in the United States.

Our strategic objective is to acquire electronic payment volume across all our financial payment processing services and strengthen our position as a financial payment processor. We also have as an objective the goal of developing revenue streams from the licensing of our intellectual property, specifically, the licensing of the intellectual property associated with our five patents regarding electronic check processing.

## Results of Operations

Three Months Ended December 31, 2003 results compared to Three Months Ended December 31, 2002

### Revenue

Our revenue consists primarily of fees from our primary and secondary check collection, electronic check authorization, electronic check conversion and transaction switching business. Revenue is recognized in accordance

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with SEC Staff Accounting Bulletin ("SAB") 101, "Revenue Recognition." Revenue from our electronic check authorization, electronic check conversion and transaction switching business is recognized at the time the transactions are processed by the merchant, provided the fee is fixed and determinable and collectibility is reasonably assured. Fees associated with our primary and secondary check collection business are contingent on successful recovery; accordingly, revenue is recognized as cash is received. In accordance with Statement of Position ("SOP") 97-2 "Software Revenue Recognition," we recognize software license revenue when all of the following criteria are met: execution of a written agreement; delivery of software; the license fee is fixed and determinable; collectibility of the proceeds is probable; and vendor-specific objective evidence exists to allocate the total fee to elements of multiple-element arrangements, including post contract customer support. Vendor specific objective evidence is based on the price charged when an element is sold separately, or if not yet sold separately, the price established by authorized management or a substantive renewal rate for post-contract customer support. If we do not have sufficient evidence of the fair value of undelivered elements, revenue is recognized ratably over the support period when the undelivered element is post-contract customer support. Any cash consideration received prior to meeting revenue recognition criteria is recorded as deferred revenue.

Total revenue was approximately \$2.4 million for the three months ended December 31, 2003 as compared to approximately \$2.5 million for the three months ended December 31, 2002. Revenue from our primary check collection business was approximately \$858,000 for the three months ended December 31, 2003 as compared to approximately \$993,000 for the three months ended December 31, 2002, a decrease of approximately 13.6%. This decrease was mainly attributable to us no longer providing electronic check recovery services to JC Penney, formerly one of our largest customers which was responsible for approximately 6% of our primary check collection revenue for the three months ended December 31, 2002. We are continuing to provide other collection services to JC Penney. Revenue from our secondary check collection business was approximately \$500,000 for the three months ended December 31, 2003 as compared to approximately \$451,000 for the three months ended December 31, 2002, an increase of approximately 10.9%. Revenue from electronic check verification and transaction switching services was approximately \$281,000 for the three months ended December 31, 2003 as compared to approximately \$345,000 for the three months ended December 31, 2002, a decrease of approximately 18.6%. The decrease was primarily attributable to us no longer providing transaction switching services to Fleming Retail Group ("Fleming"). Fleming filed for Chapter 11 reorganization in the United States Bankruptcy Court on March 31, 2003. Fleming notified us of their intention to commence closing and selling their remaining grocery retail store locations and by the conclusion of our first quarter ended June 30, 2003, Fleming had finalized the closing and selling of those remaining grocery retail store locations. Consequently, the transaction switching services previously provided by us to Fleming was no longer required and, therefore, the impact on revenue for the three months ended December 31, 2003 was approximately \$90,000.

During the three months ended December 31, 2003, we entered into an agreement regarding our intellectual property estate regarding the processing of electronic check transactions with Verus Financial Management, Inc. ("Verus"). The agreement involved a fee in exchange for a release regarding potential past infringements of our intellectual property estate by Verus. The agreement also included separate running royalty fees in exchange for a license regarding future electronic check transactions processed by Verus. The fee for the release has been recognized and

included in revenue during the three months ended December 31, 2003, and the separate running royalty fees are being recognized on a monthly basis.

During the three months ended December 31, 2003, we terminated a separate sub-license agreement that had been granted to Global eTelecom Inc. ("Global") during the three months ended June 30, 2002. The remaining balance of approximately \$256,000 of the sub-license fee paid to us by Global, which had been deferred and was being recognized over the terms of the agreement with Global, was recorded as revenue on the date of termination.

During the three months ended December 31, 2003, revenue from and associated with our four largest customers amounted to approximately 55.5% of total revenue. We may be economically dependent on revenue from these customers. During the three months ended December 31, 2003, 7-Eleven, one of our major customers, entered into a check authorization and collection transition contract with us for a term of six months with provisions for extending the contract for up to three successive additional periods of three months each. The agreement also allows for 7-Eleven to terminate the contract upon sixty days notice.

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#### Cost of operations

Cost of operations decreased from approximately \$1.8 million for the three months ended December 31, 2002, to approximately \$1.5 million for the three months ended December 31, 2003, a decrease of approximately 16.7%. Cost of operations consist of transaction processing costs, personnel costs, equipment related costs and telecommunication costs. The decrease is primarily attributable to certain cost reductions including staff made during the three months ended December 31, 2003 and the three months ended September 30, 2003. We continue to seek ways to reduce cost of operations.

#### Sales, general and administrative expenses

Sales, general and administrative expenses consist primarily of personnel costs, commissions, office facilities, travel, promotional events such as trade shows, seminars and technical conferences and public relations. Sales, general and administrative expenses increased to approximately \$631,000 from approximately \$568,000 for the three months ended December 31, 2003 and 2002, respectively, an increase of approximately 11.1%. Corporate administrative costs increased to approximately \$355,000 from approximately \$280,000 for the three months ended December 31, 2003 and 2002 respectively, an increase of approximately 26.8%. The increase in corporate administrative costs is primarily attributed to a decrease of approximately 19.3% in the value of the U.S. dollar relative to the Canadian dollar for the three months ended December 31, 2003 as compared to the three months ended December 31, 2002. This has resulted in increases in Corporate administrative costs where a number of expenses are incurred in Canadian dollars.

#### Amortization and depreciation

Amortization and depreciation decreased to approximately \$483,000 from approximately \$571,000 for the three months ended December 31, 2003 and 2002, respectively. The decrease was primarily attributable to certain capital assets, acquired through previous years' acquisitions, which had become fully depreciated.

#### Interest

Interest expense decreased to approximately \$1,000 from approximately \$4,600 for the three months ended December 31, 2003 and 2002, respectively. This decrease was due to the decrease in capital lease obligations. Interest income decreased to approximately \$13,000 from approximately \$17,000 for the three months ended December 31, 2003 and 2002, respectively. This decrease in interest earned was primarily attributed to a decrease in interest rates from an average of approximately 1.56% for the three months ended December 31, 2002 to approximately 1% for the three

months ended December 31, 2003.

#### Loss From Continuing Operations

Loss from continuing operations decreased to approximately \$233,000 from approximately \$545,000 for the three months ended December 31, 2003 and 2002, respectively. The decrease was primarily attributable to a decrease in cost of operations resulting from certain cost reductions including staff that took place during the three months ended December 31, 2003 and the three months ended September 30, 2003.

Basic and diluted loss per share were both approximately (\$0.01) for the three months ended December 31, 2003, as compared to approximately (\$0.03) for the three months ended December 31, 2002.

Nine Months Ended December 31, 2003 results compared to Nine Months Ended December 31, 2002

#### Revenue

Total revenue was approximately \$6 million for the nine months ended December 31, 2003 as compared to approximately \$6.3 million for the nine months ended December 31, 2002. Revenue from our primary check collection business was approximately \$2.6 million for the nine months ended December 31, 2003 as compared to approximately \$3.1 million for the nine months ended December 31, 2002, a decrease of approximately 16.1%. This decrease was mainly attributable to us no longer providing electronic check recovery services to JC Penney, formerly one of our largest customers which was responsible for approximately 10.1% of our primary check collection revenue for the nine months ended December 31, 2002. We are continuing to provide other collection services to JC Penney. Revenue from our secondary check collection business was approximately \$1.5 million for the nine months ended December 31,

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2003 as compared to approximately \$1.4 million for the nine months ended December 31, 2002, an increase of approximately 7.1%. Revenue from electronic check verification and transaction switching services increased approximately 7.3% from approximately \$836,000 for the nine months ended December 31, 2002 to approximately \$897,000 for the nine months ended December 31, 2003. The increase is mainly attributable to the rollout of check processing services, including electronic check verification, to 49 multi-lane grocery stores with 268 locations in the Houston, Texas area during the third quarter of fiscal year 2003.

During the nine months ended December 31, 2003, we entered into an agreement regarding our intellectual property estate regarding the processing of electronic check transactions with Verus Financial Management, Inc. ("Verus"). The agreement involved a fee in exchange for a release regarding potential past infringements of our intellectual property estate by Verus. The agreement also included separate running royalty fees in exchange for a license regarding future electronic check transactions processed by Verus. The fee for the release has been recognized and included in revenue during the nine months ended December 31, 2003, and the separate running royalty fees are being recognized on a monthly basis.

During the nine months ended December 31, 2003, we terminated a separate sub-license agreement that had been granted to Global eTelecom Inc. ("Global") during the three months ended June 30, 2002. The remaining balance of approximately \$256,000 of the sub-license fee paid to us by Global, which had been deferred and was being recognized over the terms of the agreement with Global, was recorded as revenue on the date of termination.

During the nine months ended December 31, 2003, revenue from and associated with our two largest customers amounted to approximately 35.5% of total revenue. We may be economically dependent on revenue from these customers. During the nine months ended December 31, 2003, 7-Eleven, one of our largest customers, informed us

that they would not be renewing their contract for check authorization and recovery services with us. During the past seven quarters, we recorded revenue of approximately \$480,000 per quarter directly attributable to this contract. This contract ended on November 30, 2003, and subsequently 7-Eleven entered into a new check authorization and collection transition contract with us for a term of six months with provisions for extending this contract for up to three successive additional periods of three months each. The agreement also allows for 7-Eleven to terminate the contract upon sixty days notice.

On March 31, 2003, Fleming Retail Group ("Fleming"), one of our customers we previously provided transaction switching services to, filed for Chapter 11 reorganization in the United States Bankruptcy Court. During the nine months ended December 31, 2003, Fleming notified us of its intention to commence closing and selling their remaining grocery retail store locations and by the conclusion of the nine months ended December 31, 2003, Fleming had finalized the closing and selling of these remaining grocery retail store locations. Consequently, the transaction switching services previously provided by us to Fleming is no longer required and, therefore, the resulting impact on future revenue is a reduction of approximately \$90,000 per quarter or approximately 4% of our total revenue.

#### Cost of operations

Cost of operations was approximately \$4.9 million for the nine months ended December 31, 2003, as compared to approximately \$4.9 million for the nine months ended December 31, 2002. Cost of operations consist of transaction processing costs, personnel costs, equipment related costs and telecommunication costs. During the nine months ended December 31, 2003, we made certain cost reductions including staff which we expect to result in a reduction of our cost of operations by approximately \$200,000 per quarter. We continue to seek ways to reduce cost of operations.

#### Sales, general and administrative expenses

Sales, general and administrative expenses consist primarily of personnel costs, commissions, office facilities, travel, promotional events such as trade shows, seminars and technical conferences and public relations. Sales, general and administrative expenses were approximately \$1.9 million for the nine months ended December 31, 2003 as compared to approximately \$1.8 million for the nine months ended December 31, 2002. Corporate administrative costs increased to approximately \$998,000 from approximately \$833,000 for the nine months ended December 31, 2003 and 2002 respectively, an increase of approximately 19.8%. The increase in corporate administrative costs is primarily attributed to a decrease of approximately 14.5% in the value of the U.S. dollar relative to the Canadian dollar for the nine months ended December 31, 2003 as compared to the nine months ended December 31, 2002. This has resulted in increases in Corporate administrative costs where a number of expenses are incurred in Canadian dollars.

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#### Amortization and depreciation

Amortization and depreciation decreased to approximately \$1.6 million from approximately \$1.8 million for the nine months ended December 31, 2003 and 2002, respectively. The decrease was primarily attributable to certain capital assets, acquired through previous years' acquisitions, which had become fully depreciated.

#### Interest

Interest expense decreased to approximately \$3,000 from approximately \$18,000 for the nine months ended December 31, 2003 and 2002, respectively. This decrease was due to the decrease in capital lease obligations. Interest income decreased to approximately \$42,000 from approximately \$54,000 for the nine months ended December 31, 2003 and 2002, respectively. This decrease in interest earned was primarily attributed to a decrease in interest rates from an average of approximately 1.54% for the nine months ended December 31, 2002 to approximately 1% for the nine months ended December 31, 2003.



### Loss from continuing operations

Loss from continuing operations increased to approximately \$2.4 million from approximately \$2.3 million for the nine months ended December 31, 2003 and 2002, respectively. The increase was primarily attributable to a decrease in revenue from our primary check collection business.

Basic and diluted loss per share from continuing operations were both approximately (\$0.12) for the nine months ended December 31, 2003, and December 31, 2002.

### Results of Operations - discontinued operations

During the nine months ended December 31, 2003, we sold our Wildwood Estates property, previously reported in a separate business segment, for total gross proceeds of approximately \$2.4 million cash. We recorded net profit of approximately \$588,000, which was primarily attributed to a net gain of approximately \$625,000 from the sale of real property and capital assets offset by a net loss of approximately \$37,000 from discontinued operations. The decision to discontinue operations of this business segment resulted from an opportunity to sell the property and consequently remove a business segment which was no longer consistent with our business strategy.

### Liquidity and Capital Resources

Our liquidity and financial position consisted of approximately \$4.8 million in working capital as of December 31, 2003, compared to approximately \$3.6 million in working capital as of March 31, 2003. The increase in working capital was attributable to cash flows provided by discontinued operations of approximately \$2.2 million offset by cash used in operating activities of continuing operations of approximately \$766,000. Cash used in operating activities of continuing operations related to normal operating activities and a decrease in accounts payable and accrued liabilities of approximately \$48,000, a decrease of prepaid expenses of approximately \$174,000, a decrease in accounts receivable of approximately \$24,000, a decrease in other assets of approximately \$206,000 and a decrease in deferred revenue of approximately \$396,000. Cash flows used in continuing operations were approximately \$766,000 as compared to approximately \$1.2 million for the nine months ended December 31, 2003 and 2002, respectively. Cash used in investing activities of continuing operations was approximately \$264,000 as compared to approximately \$251,000 for the nine months ended December 31, 2003 and 2002, respectively. The increase during the nine months ended December 31, 2003 was due mainly to an increase in short term investments of approximately \$184,000 offset by a reduction in capital asset expenditures. Short term investments are fixed investments of cash with a term of maturity greater than three months. Cash used in financing activities of continuing operations was approximately \$55,000 for the nine months ended December 31, 2003, as compared to cash provided by financing activities of approximately \$302,000 for the nine months ended December 31, 2002. The decrease in cash provided by financing activities is primarily due to the decrease in proceeds from the exercise of options of our common stock.

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We believe that existing cash and cash equivalent balances, and potential cash flows from operations should satisfy our working capital and capital expenditure requirements in the foreseeable future. However, any material acquisitions of complementary businesses, products or technologies, other arrangements, unexpected losses, or an economic slowdown in the retail industry could require us to obtain additional equity or debt financing. There can be no assurance that such financing would be available on acceptable terms, if at all.

### Critical Accounting Policies

There have been no changes to our critical accounting policies since March 31, 2003. For a description of our critical accounting policies, see our Annual Report on Form 10-K for the year ended March 31, 2003 filed with the Securities and Exchange Commission.

## Contingencies

In addition to the legal matters previously reported in our Annual Report filed on Form 10-K for the year ended March 31, 2003, as filed with the Securities and Exchange Commission on June 27, 2003 (file no. 0-13959), we are party from time to time to ordinary litigation incidental to our business, none of which is expected to have a material adverse effect on our results of operations, financial position or liquidity.

### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

From March 31, 2003, until December 31, 2003, there were no material changes from the information concerning market risk contained in our Annual Report on Form 10-K for the year ended March 31, 2003, as filed with the Securities and Exchange Commission on June 27, 2003 (file no. 0-13959).

### ITEM 4. Controls and Procedures

The Corporation's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, and the conclusions of the principal executive and principal financial officers, based on an evaluation of these controls and procedures, are that the controls and procedures are effective as of December 31, 2003 at the reasonable assurance level.

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## PART II.

### OTHER INFORMATION

#### ITEM 1. Legal Proceedings

There are no material changes with respect to the information concerning legal proceedings contained in our Annual Report on Form 10-K for the year ended March 31, 2003, as filed with the Securities and Exchange Commission on June 27, 2003 (file no. 0-13959). In addition to the legal matters as described herein and as previously reported in our most recent report on Form 10-K, we are party from time to time to ordinary litigation incidental to our business, none of which is expected to have a material adverse effect on our results of operations, financial position or liquidity.

#### ITEM 6. Exhibits and Reports on Form 8-K

- Exhibits:

Exhibit	Description of Document
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3.1	Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q for the period ended September 30, 2000, of LML Payment Systems Inc. (File No. 0-13959)).
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3.2	Bylaws (incorporated by reference to Exhibit 1.2 to the Annual Report on Form 20-F for the fiscal year ended March 31, 1998, of LML Payment Systems Inc. (File No. 0-13959)).
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3.3	Amendment to Bylaws of LML Payment Systems Inc. (incorporated by reference to Exhibit 3.3 to the Quarterly Report on Form 10-Q for the period ended September 30, 2001, of LML Payment Systems Inc. (File No. 0-13959)).
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31.1 Rule 13a-14(a) Certification of Chief Executive Officer (filed herewith).

31.2 Rule 13a-14(a) Certification of Principal Financial Officer (filed herewith).

32.1 Section 1350 Certification of Chief Executive Officer (furnished herewith).

32.2 Section 1350 Certification of Controller and Chief Accounting Officer (furnished herewith).

- Reports on Form 8-K

We filed the following Current Reports on Form 8-K with the Securities and Exchange Commission during the quarter ended December 31, 2003:

- i) A current report on Form 8-K, dated November 14, 2003, was filed on November 17, 2003 (Items 5 and 7)

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LML PAYMENT SYSTEMS INC.

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LML PAYMENT SYSTEMS INC.

By: /s/ Richard R. Schulz

Chief Accounting Officer (Duly Authorized Officer and Chief Accounting Officer)

Date: February 13, 2004