LML PAYMENT SYSTEMS INC
Form 10-Q
November 14, 2003

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

Form 10-Q

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

For the Quarterly Period Ended September 30, 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	(I.R.S. Employer Identification No.)
incorporation or organization)	

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 [X] No [ ]

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 October 31, 2003, was 19,605,561.

LML PAYMENT SYSTEMS INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 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)

	September 30, 2003 $ (Unaudited)	March 31, 2003 $
ASSETS		
Current Assets		
Cash and cash equivalents	4,646,137	3,483,690
Restricted cash	300,000	300,000
Accounts receivable, less allowances of $103,253 and $60,815, respectively	453,178	583,969
Prepaid expenses	460,506	540,303
Total Current Assets	5,859,821	4,907,962
Real Property Held for Sale, net	-	1,580,020
Capital Assets, net	2,365,944	3,291,517
Patents, net	1,389,395	1,454,270
Other Assets	238,665	319,514
TOTAL ASSETS	9,853,825	11,553,283
LIABILITIES		
Current Liabilities		
Accounts payable	519,505	504,869
Accrued liabilities	165,539	216,513
Accrued compensation	250,296	257,667
	-	90,016

Current portion of capital lease obligations		
Current portion of deferred revenue	259,323	277,350
Total Current Liabilities	1,194,663	1,346,415
Deferred revenue	229,909	243,927
Total Liabilities	1,424,572	1,590,342
SHAREHOLDERS' EQUITY		
Capital Stock		
Class A, preferred stock, $1.00 CDN	-	-
par value, 150,000,000 shares authorized,	-	-
issuable in series, none issued or outstanding	30,394,311	30,350,561
Class B, preferred stock, $1.00 CDN par value, 150,000,000 shares authorized, issuable in series, none issued or outstanding		
Common shares, no par value, 100,000,000 shares authorized, 19,605,561 and 19,593,061 shares issued and outstanding, respectively		
Deficit	(21,965,058)	(20,387,620)
Total Shareholders' Equity	8,429,253	9,962,941

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	9,853,825	11,553,283

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 Months Ended September 30		Six Months Ended September 30	
	2003 $	2002 $	2003 $	2002 $
REVENUE	1,773,113	1,948,830	3,669,776	3,827,717
COSTS AND EXPENSES				
Cost of operations	1,658,527	1,523,076	3,416,404	3,103,789
Sales, general and administrative	669,630	559,762	1,282,458	1,274,850
Amortization and depreciation	526,365	615,554	1,098,813	1,230,187
Other expenses	40,338	14,474	56,685	8,285
LOSS FROM CONTINUING OPERATIONS BEFORE	(1,121,747)	(764,036)	(2,184,584)	(1,789,394)

INTEREST INCOME AND INCOME TAXES				
Interest income, net	17,836	11,974	27,437	23,830
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(1,103,911)	(752,062)	(2,157,147)	(1,765,564)
State income taxes	4,200	-	8,400	-
LOSS FROM CONTINUING OPERATIONS	(1,108,111)	(752,062)	(2,165,547)	(1,765,564)
Discontinued operations (Note 3)	(11,317)	(17,872)	588,109	(34,945)
NET LOSS	(1,119,428)	(769,934)	(1,577,438)	(1,800,509)
DEFICIT, beginning of period	(20,845,630)	(18,370,110)	(20,387,620)	(10,905,949)
Change in accounting policy	-	-	-	(6,433,586)
DEFICIT, end of period	(21,965,058)	(19,140,044)	(21,965,058)	(19,140,044)

LOSS PER SHARE				
Basic loss per share				
Loss from continuing operations	(0.06)	(0.04)	(0.11)	(0.09)
Net loss	(0.06)	(0.04)	(0.08)	(0.09)
Diluted loss per share				
Loss from continuing operations	(0.06)	(0.04)	(0.11)	(0.09)
Net loss	(0.06)	(0.04)	(0.08)	(0.09)
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	19,594,572	19,451,061	19,593,812	19,450,869
Diluted	19,594,572	19,451,061	19,593,812	19,450,869

See accompanying notes to the consolidated financial statements.

LML PAYMENT SYSTEMS INC.

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

(Unaudited)

	Three Months Ended September 30		Six Months Ended September 30	
	2003	2002	2003	2002
	$	$	$	$

Operating Activities:				
Loss from continuing operations	(1,108,111)	(752,062)	(2,165,547)	(1,765,564)
Adjustments to reconcile loss from continuing operations to net cash (used in) provided by operating activities				
Provision for losses on accounts receivable	-	-	42,439	-
Amortization and depreciation	526,365	615,554	1,098,813	1,230,187
Other	41,519	-	41,519	-
Changes in operating assets and liabilities				
Accounts receivable	(41,018)	142,398	19,333	(119,712)
Prepaid expenses	(11,230)	3,410	71,194	187,830
Accounts payable and	243,299	20,487	15,035	(334,246)

accrued liabilities				
Other assets	24,001	(140,219)	23,268	(133,364)
Deferred revenue	24,852	108,715	(32,045)	334,431
Net cash used in operating activities of continuing operations	(300,323)	(1,717)	(885,991)	(600,438)
Investing Activities:				
Capital asset expenditures	(49,105)	(111,931)	(56,231)	(148,765)
Patents	-	(2,557)	(7,306)	(5,845)
Net cash used in investing activities of continuing operations	(49,105)	(114,488)	(63,537)	(154,610)
Financing Activities:				
Payments on capital leases	(48,648)	(82,920)	(90,016)	(186,501)
Proceeds from exercise of stock options	43,750	-	43,750	17,325
Net cash used in financing activities of	(4,898)	(82,920)	(46,266)	(169,176)

continuing operations				
Net cash used in continuing operations	(354,326)	(199,125)	(995,794)	(924,224)
Net cash (used in) provided by discontinued operations (Note 3)	(26,621)	(20,116)	2,158,241	(51,089)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(380,947)	(219,241)	1,162,447	(975,313)
Cash and cash equivalents, beginning of period	5,027,084	3,826,232	3,483,690	4,582,304
Cash and cash equivalents, end of period	4,646,137	3,606,991	4,646,137	3,606,991

See accompanying notes to the consolidated financial statements.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

The consolidated balance sheet as of September 30, 2003 and the consolidated statements of operations and deficit and cash flows for the three months and six months ended September 30, 2002 and 2003 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 audited 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.

2. 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 of adoption had we recorded compensation expense under the fair value method. During the three months and six months ended September 30, 2003, there were 40,000 stock options granted. The pro forma compensation expense recorded during the three months and six months ended September 30, 2003 represents the amortization of previously issued stock options as well as the stock options granted during the three and six months ended September 30, 2003. These options are amortized to pro forma compensation expense as the options vest.

	Three Months Ended September 30		Six Months Ended September 30	
	2003 $	2002 $	2003 $	2002 $
Net loss				
As reported	(1,119,428)	(769,934)	(1,577,438)	(1,800,509)
Compensation cost	520,663	1,738,705	1,284,517	2,617,463
Pro forma	(1,640,091)	(2,508,639)	(2,861,955)	(4,417,972)
Net loss per share				
As reported	(0.06)	(0.04)	(0.08)	(0.09)
Pro forma	(0.08)	(0.13)	(0.15)	(0.23)

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 six months ended September 30, 2003:

Risk free interest rate of 4% for the three months and six months ended September 30, 2003;

Expected volatility of 104% for three months and six months ended September 30,2003;

Expected life of the options of 4 years for the three months and six months ended September 30, 2003;

No dividend yields.

3. 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 six months ended September 30, 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 six months ended September 30, 2003 and 2002. The results of operations of the Residential Real Estate Operations segment are as follows:

Consolidated Statements of Operations	Three Months ended September 30		Six Months ended September 30	
	2003 $	2002 $	2003 $	2002 $
Revenue	200	43,177	35,662	82,407
Net loss from discontinued operations	(11,317)	(17,872)	(36,933)	(34,945)
Net gain from sale of property (a)	-	-	625,042	-
Discontinued operations	(11,317)	(17,872)	588,109	(34,945)

(a) Assets included as part of the disposal group:

Real Property - Held for sale	
Land held for resale	584,672
Common area land	803,554
Common area building	227,125
Total cost	1,615,351
Less: accumulated depreciation	36,846
Net book value	1,578,505
Capital assets	
Computer equipment	2,056
Furniture and fixtures	37,407

Total cost	39,463
Less: accumulated depreciation	28,123
Net book value	11,340
Total net book value	1,589,845
Net proceeds from sale of property	2,214,887
Net gain from sale of property	625,042

Consolidated balance sheets	September 30, 2003 $	March 31, 2003 $
Cash	8,564	12,443
Accounts receivable - net	41,220	27,542
	-	8,603

Prepaid expenses		
Total current assets of discontinued operations	49,784	48,588
Real property - held for sale	-	1,580,020
Capital assets	-	12,753
Total assets of discontinued operations	49,784	1,641,361
Current liabilities	84,291	101,856
Total liabilities of discontinued operations	84,291	101,856

Consolidated statements of cash flows

Three Months ended
September 30

Six Months ended
September 30

Cash flows (used in) provided by discontinued operations

	2003 $
	2002 $
	2003 $
	2002 $
Operating activities	
	(26,621)
	(18,085)
	(56,646)
	(49,058)
Investing activities	
	-
	(2,031)
	2,214,887
	(2,031)

Net cash provided by (used in) discontinued operations	
	(26,621)
	(20,116)
	2,158,241
	(51,089)

4. Industry and Geographic Segments

Financial Payment Processing Operations U.S.			
Three Months ended September 30		Six Months ended September 30	
2003	2002	2003	2002

	$	$	$	$
Revenue	1,773,113	1,948,830	3,668,776	3,826,717
Revenue major customers	683,295	994,497	1,366,157	2,114,652
Segment operating loss	(774,145)	(442,373)	(1,522,618)	(1,212,524)
Total assets	7,121,043	7,122,404	7,121,043	7,122,404

Corporate Canada				
	Three Months ended September 30		Six Months ended September 30	
	2003	2002	2003	2002
	$	$	$	$
Revenue	-	-	1,000	1,000
Segment operating loss	(333,966)	(309,689)	(642,929)	(553,040)
Total assets	2,682,998	3,734,188	2,682,998	3,734,188

The Financial Payment Processing Operations involve electronic check authorization, electronic check conversion (ECC) and primary and secondary check collection including electronic check re-presentment (RCK). Corporate is the corporate administration of the Corporation's headquarters. There were no inter-segment sales.

5. 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:

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.

Discontinued Operations

In a separate business segment, we owned and managed a 332-acre manufactured home retirement property known as Wildwood Estates, in Wildwood, Florida. Operations included the sale of manufactured homes and lots. In exchange for monthly maintenance fees, we provided the resident community with certain amenities and services commonly associated with similar developments. In June 2003, we sold the Wildwood Estates property for total gross proceeds of approximately $2.4 million cash. (See "Results of Operations - Discontinued Operations" located in

"Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A") and Note 3 to the Consolidated Financial Statements in Part I, Item 1).

Results of Operations

Three Months Ended September 30, 2003 results compared to Three Months Ended September 30, 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 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 collectability 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 substantitive 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. Revenue regarding Wildwood Estates was recognized when sales of property lots and mobile homes were completed. Maintenance fees from the management of the property and from the maintenance of the common areas were recognized straight line over the service period.

Total revenue was approximately $1.8 million for the three months ended September 30, 2003 as compared to approximately $1.9 million for the three months ended September 30, 2002. Revenue from our primary check collection business was approximately $840,000 for the three months ended September 30, 2003 as compared to approximately $1.1 million for the three months ended September 30, 2002, a decrease of approximately 23.6%. 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 12.3% of our primary check collection revenue for the three months ended September 30, 2002. We are continuing to provide other primary collection services to JC Penney. Revenue from our secondary check collection business was approximately $492,000 for the three months ended September 30, 2003 as compared to approximately $415,000 for the three months ended September 30, 2002, an increase of approximately 18.6%. Revenue from electronic check verification increased approximately 16% from approximately $244,000 for the three months ended September 30, 2002 to approximately $283,000 for the three months ended September 30, 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. Revenue from the licensing of certain modules of our software decreased approximately $10,000 for the three months ended September 30, 2003. The increase in electronic check verification revenue is consistent with our strategic objective of acquiring electronic payment volume across all our financial payment processing services and strengthening our position as a financial payment processor.

During the three months ended September 30, 2003, revenue from and associated with our two largest customers amounted to approximately 38.5% of total revenue. We may be economically dependent on revenue from these customers. During the three months ended September 30, 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 six quarters, we recorded revenue of approximately $480,000 per quarter directly attributable to this contract. The contract is scheduled to terminate at the end of November 2003.

Costs of operations

Costs of operations increased from approximately $1.5 million for the three months ended September 30, 2002, to approximately $1.7 million for the three months ended September 30, 2003, an increase of approximately 13.3%. Cost of operations consist of transaction processing costs, personnel costs, equipment related costs and telecommunication

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costs. The increase was partially attributable to an increase in traditional collection services versus a decrease in electronic check recovery services resulting from the removal of the electronic check recovery services previously provided to JC Penney. Services such as electronic check recovery, provide us with a greater gross margin due to utilization of more cost efficient electronic check recovery methods as compared to more labor-intensive traditional check recovery methods. During the three months ended September 30, 2003, we made certain adjustments including certain staff reductions 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 costs 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 $670,000 from approximately $560,000 for the three months ended September 30, 2003 and 2002, respectively, an increase of approximately 19.6%. The increase in sales, general and administrative expense is primarily attributable to an increase in sales personnel. The declining value of the U.S. dollar 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 $526,000 from approximately $616,000 for the three months ended September 30, 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 a credit of approximately $3,000 from an expense of approximately $6,000 for the three months ended September 30, 2003 and 2002, respectively. This decrease was due to an adjustment of interest expense for our final payment of our capital lease obligation during the three months ended September 30, 2003. Interest income decreased to approximately $15,000 from approximately $18,000 for the three months ended September 30, 2003 and 2002, respectively. This decrease in interest earned was primarily attributed to a decrease in interest rates from an average of approximately 1.53% for the three months ended September 30, 2002 to approximately 1% for the three months ended September 30, 2003.

Loss from continuing operations

Loss from continuing operations increased to approximately $1.1 million from approximately $752,000 for the three months ended September 30, 2003 and 2002, respectively. The increase was primarily attributable to a decrease in electronic check recovery services revenue and an increase in cost of operations resulting from an increase in traditional check collection services as well as an increase in sales, general and administrative expenses resulting from an increase in sales personnel and general corporate expenses.

Basic and diluted loss per share from continuing operations were both approximately ($0.06) for the three months ended September 30, 2003, as compared to approximately ($0.04) for the three months ended September 30, 2002.

Six Months Ended September 30, 2003 results compared to Six Months Ended September 30, 2002

Revenue

Total revenue was approximately $3.7 million for the six months ended September 30, 2003 as compared to approximately $3.8 million for the six months ended September 30, 2002. Revenue from our primary check collection business was approximately $1.7 million for the six months ended September 30, 2003 as compared to approximately $2 million for the six months ended September 30, 2002, a decrease of approximately 15%. 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 12.6% of our primary check collection revenue for the six months ended September 30, 2002. We are continuing to provide other primary collection services to JC Penney. Revenue from our secondary check collection business was approximately $1 million for the six months ended September 30, 2003 as compared to approximately $911,000 for the six months ended September 30, 2002, an increase of approximately 9.8%. Revenue from electronic check verification increased approximately 25.5% from approximately

$491,000 for the six months ended September 30, 2002 to approximately $616,000 for the six months ended September 30, 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. Revenue from the licensing of certain modules of our software increased approximately $35,000 for the six months ended September 30, 2003. The increases in electronic check verification revenue and software licensing revenue is consistent with our strategic objective of acquiring electronic payment volume across all our financial payment processing services and strengthening our position as a financial payment processor.

During the six months ended September 30, 2003, revenue from and associated with our two largest customers amounted to approximately 37.2% of total revenue. We may be economically dependent on revenue from these customers. During the six months ended September 30, 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 six quarters, we recorded revenue of approximately $480,000 per quarter directly attributable to this contract. The contract is scheduled to terminate at the end of November 2003.

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 six months ended September 30, 2003, Fleming notified us of its intention to commence closing and selling their remaining grocery retail store locations and by the conclusion of the six months ended September 30, 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

Costs of operations increased from approximately $3.1 million for the six months ended September 30, 2002, to approximately $3.4 million for the six months ended September 30, 2003, an increase of approximately 9.7%. Cost of operations consist of transaction processing costs, personnel costs, equipment related costs and telecommunication costs. The increase was partially attributable to an increase in traditional collection services versus a decrease in electronic check recovery services resulting from the removal of the electronic check recovery services previously provided to JC Penney. Services such as electronic check recovery, provide us with a greater gross margin due to utilization of more cost efficient electronic check recovery methods as compared to more labor-intensive traditional check recovery methods. The increase was also attributable to a provision for losses on accounts receivable from Fleming Retail Group of approximately $42,000 resulting from their bankruptcy. During the six months ended September 30, 2003, we made certain adjustments including certain staff reductions 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 costs 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 $1.3 million for the six months ended September 30, 2003 as compared to approximately $1.3 million for the six months ended September 30, 2002.

Amortization and depreciation

Amortization and depreciation decreased to approximately $1.1 million from approximately $1.2 million for the six months ended September 30, 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 $2,000 from approximately $14,000 for the six months ended September 30, 2003 and 2002, respectively. This decrease was due to the decrease in capital lease obligations. Interest income decreased to approximately $29,000 from approximately $38,000 for the six months ended September 30, 2003 and 2002, respectively. This decrease in interest earned was primarily attributed to a decrease in interest

rates from an average of approximately 1.62% for the six months ended September 30, 2002 to approximately 1% for the six months ended September 30, 2003.

Loss from continuing operations

Loss from continuing operations increased to approximately $2.2 million from approximately $1.8 million for the six months ended September 30, 2003 and 2002, respectively. The increase was primarily attributable to an increase in cost of operations resulting from an increase in traditional check collection services as well as an increase in our provision for losses on accounts receivable.

Basic and diluted loss per share from continuing operations were both approximately ($0.11) for the six months ended September 30, 2003, as compared to approximately ($0.09) for the six months ended September 30, 2002.

Results of Operations - discontinued operations

During the six months ended September 30, 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 $4.7 million in working capital as of September 30, 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 $886,000. Cash used in operating activities of continuing operations related to normal operating activities and an increase in accounts payable and accrued liabilities of approximately $15,000, a decrease of prepaid expenses of approximately $71,000 and a decrease in accounts receivable of approximately $19,000. Cash flows used in continuing operations were approximately $886,000 as compared to approximately $600,000 for the six months ended September 30, 2003 and 2002, respectively. Cash used in investing activities of continuing operations was approximately $64,000 as compared to approximately $155,000 for the six months ended September 30, 2003 and 2002, respectively. The decrease during the six months ended September 30, 2003 was due mainly to a reduction in capital asset expenditures. Cash used in financing activities of continuing operations was approximately $46,000 for the six months ended September 30, 2003, as compared to approximately $169,000 for the six months ended September 30, 2002. The decrease in cash used in financing activities is primarily due to the decrease in payments on capital leases.

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 September 30, 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 September 30, 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 4. Submission of Matters to a Vote of Security Holders

At the Corporation's Annual General Meeting of Shareholders held August 20, 2003 (the "Meeting"), the following proposals were adopted by shareholders of the Corporation (the "Shareholders") by ordinary resolution: (1) to elect PATRICK H. GAINES, GREG A. MACRAE, L. WILLIAM SEIDMAN, ROBIN B. MARTIN and JACQUELINE PACE as directors of the Corporation for terms expiring at the Annual General Meeting of Shareholders in 2004, as described in the Corporation's Information Circular and Proxy Statement for the Meeting; and (2) to appoint Ernst & Young LLP as auditor of the Corporation to hold office until the Annual General Meeting of Shareholders in 2004.

The number of shares cast for, against, withheld and spoiled, as well as the number of abstentions and broker non-votes as to each of these matters, are as follows:

PROPOSAL

SHARES
FOR

SHARES AGAINST

WITHHELD

SPOILED

ABSTENTIONS

BROKER NON-VOTES

Ordinary Resolutions:

1.

Election of Directors

:

a. Patrick H. Gaines

15,953,811

0

74

0

0

0

b. Greg A. MacRae

15,903,747

0

116

0

0

0

c. L. William Seidman

15,953,600

0

285

0

0

0

d. Robin B. Martin

15,953,811

0

74

0

0

0

e. Jacqueline Pace

15,903,747

0

116

0

0

0

2.

Appointment of Ernst & Young LLP, as Auditors

15,953,651

0

169

65

0

0

ITEM 6. Exhibits and Reports on Form 8-K

• Exhibits:

Exhibit Number	Description of Document
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)).
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)).

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)).
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 September 30, 2003:

i) A current report on Form 8-K, dated June 18, 2003, was filed on July 3, 2003 (Items 2 and 7)
ii) A current report on Form 8-K, dated July 24, 2003, was filed on July 25, 2003 (Item 5)
iii) An amended current report on Form 8-K, dated June 18, 2003, was filed on August 21, 2003 (Item 7)

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: November 14, 2003