LML PAYMENT SYSTEMS INC
Form 10-Q
August 14, 2012

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 June 30, 2012

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: 000-13959

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

Yukon Territory	###-##-####
(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 [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405) of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ ] No [X] (not applicable to registrant)

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filed [ ]	Accelerated Filer [ ]	Non-Accelerated Filer [ ] (Do not check if a smaller reporting company)	Smaller Reporting Company [X]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).Yes []No [X]

The number of shares of the registrant's Common Stock outstanding as of August 3, 2012 was 28,246,684.

LML PAYMENT SYSTEMS INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2012

INDEX

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

FINANCIAL INFORMATION
PART
I.
CONSOLIDATED FINANCIAL STATEMENTS
ITEM
1.

LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(In U.S. Dollars, except as noted below)
(unaudited)

ASSETS	June 30, 2012	March 31, 2012 (Restated – Note 2)
Current Assets		
Cash and cash equivalents	$27,560,561	$26,783,754
Funds held for merchants	12,954,151	9,485,182
Short-term investments	3,237,169	3,290,393
Restricted cash (Note 5(b))	175,000	175,000
Accounts receivable, less allowance of $26,867 (March 31, 2012 - $27,397)	1,428,230	1,272,580
Inventory	38,205	-
Corporate taxes receivable	275,606	373,939
Prepaid expenses	271,585	331,361
Total current assets	45,940,507	41,712,209
Property and equipment, net	123,305	121,496
Patents	75,775	120,457
Restricted cash (Note 5(b))	254,896	258,095
Deferred tax assets	855,673	809,951
Goodwill	17,874,202	17,874,202
Other intangible assets	3,596,250	3,720,037
Other assets	20,624	20,796
Total assets	$68,741,232	$64,637,243
LIABILITIES		
Current Liabilities		
Accounts payable	$674,894	$720,666
Accrued liabilities	1,412,982	1,445,490
Corporate taxes payable	835,439	386,607
Funds due to merchants	12,954,151	9,485,182
Current portion of obligations under finance lease	2,460	2,460
Current portion of deferred revenue	1,092,814	1,342,828
Total current liabilities	16,972,740	13,383,233

Obligations under finance lease	4,125	4,920
Total liabilities	16,976,865	13,388,153
EQUITY		
Capital Stock		
Class A, preferred stock, $1.00 CDN par value, 150,000,000 shares authorized, issuable in series, none issued or outstanding	-	-
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, 28,246,684 issued and outstanding (March 31, 2012 - 28,246,684)	53,918,912	53,918,912
Contributed surplus	10,200,701	10,001,594
Warrants	113,662	113,662
Deficit	(12,610,231)	(13,057,560)
Accumulated other comprehensive income	141,323	272,482
Total equity	51,764,367	51,249,090
Total liabilities and equity	$68,741,232	$64,637,243

Approved by the Board and authorized for issuance on August 9, 2012

/s/ Patrick H. Gaines
Board of Directors

/s/ Greg A. MacRae
Board of Directors

See accompanying notes to the unaudited consolidated financial statements.

LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME
(In U.S. Dollars, except share data)
(unaudited)

	Three Months Ended June 30	
	2012	2011 (Restated - Note 2)
REVENUE	$5,613,032	$5,969,265
COST OF REVENUE	3,250,972	3,321,826
GROSS PROFIT	2,362,060	2,647,439
OPERATING EXPENSES		
General and administrative	966,187	931,004
Sales and marketing	251,224	307,510
Product development and enhancement	309,974	273,695
INCOME BEFORE OTHER INCOME AND INCOME TAXES	834,675	1,135,230
Foreign exchange (loss) gain	(4,206)	31,650
Interest income	26,757	17,177
INCOME BEFORE INCOME TAXES	857,226	1,184,057
Income tax expense (recovery)		
Current	455,619	206,197
Deferred	(45,722)	290,514
	409,897	496,711
NET INCOME	447,329	687,346
OTHER COMPREHENSIVE INCOME		
Unrealized foreign exchange (loss) gain on translation of foreign operations	(131,159)	14,363
TOTAL COMPREHENSIVE INCOME	$316,170	$701,709
EARNINGS PER SHARE, basic and diluted	$0.02	$0.02
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	28,246,684	28,149,725
Diluted	28,626,607	28,987,253

See accompanying notes to the unaudited consolidated financial statements.

LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In U.S. Dollars)
(unaudited)

	Common Shares	Amount	Contributed Surplus	Warrants	Accumulated Other Comprehensive Income (Loss)	Deficit	Total
Balance as at April 1, 2011	28,127,184	$53,557,276	$8,819,006	$113,662	$ 394,554	$(19,563,201)	$43,321,297
Net income (Restated – Note 2)	-	-	-	-	-	687,346	687,346
Change in cumulative translation adjustment	-	-	-	-	14,363	-	14,363
Exercise of stock options	106,250	205,375	-	-	-	-	205,375
Reallocation of contributed surplus on exercise of options	-	121,008	(121,008)	-	-	-	-
Share-based payments	-	-	136,437	-	-	-	136,437
Balance as at June 30, 2011 (Restated – Note 2)	28,233,434	$53,883,659	$8,834,435	$113,662	$ 408,917	$(18,875,855)	$44,364,818
Balance as at April 1, 2012	28,246,684	$53,918,912	$10,001,594	$113,662	$ 272,482	$(13,057,560)	$51,249,090
Net income	-	-	-	-		447,329	447,329
Change in cumulative translation adjustment	-	-	-	-	(131,159)	-	(131,159)
Share-based payments	-	-	199,107	-	-	-	199,107
Balance as at June 30, 2012	28,246,684	$53,918,912	$10,200,701	$113,662	$ 141,323	$(12,610,231)	$51,764,367

See accompanying notes to the unaudited consolidated financial statements.

LML PAYMENT SYSTEMS INC.

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

	Three Months Ended June 30	
	2012	2011 (Restated - Note 2)
Operating Activities:		
Net income	$447,329	$687,346
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Amortization of property and equipment	22,200	34,240
Amortization of intangible assets	168,469	165,645
Share-based payments	199,107	136,437
Deferred income taxes	(45,722)	290,514
Foreign exchange loss (gain)	53,981	(3,703)
Changes in non-cash operating working capital		
Accounts receivable	(180,243)	(874,550)
Corporate taxes receivable	97,098	(59,169)
Inventory	(38,505)	-
Prepaid expenses	56,716	21,507
Accounts payable and accrued liabilities	(52,376)	(138,024)
Corporate taxes payable	460,078	(4,338,755)
Deferred revenue	(241,025)	(309,206)
Net cash provided by (used in) operating activities	947,107	(4,387,718)
Investing Activities:		
Acquisition of property and equipment	(26,531)	(21,242)
Net cash used in investing activities	(26,531)	(21,242)
Financing Activities:		
Proceeds from exercise of stock options	-	205,375
Net cash provided by financing activities	-	205,375
Effects of foreign exchange rate changes on cash and cash equivalents	(143,769)	12,387
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	776,807	(4,191,198)
Cash and cash equivalents, beginning of period	26,783,754	26,917,491
Cash and cash equivalents, end of period	$27,560,561	$22,726,293

Supplemental disclosure of cash flow information		
Interest paid	$-	$-
Taxes paid	$-	$4,599,921

See accompanying notes to the unaudited consolidated financial statements.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Nature of Operations

LML Payment Systems Inc. (a Yukon Territory corporation) and its subsidiaries (the "Corporation"), see Note 3, is a financial payment processor providing electronic payment, risk management, and authentication services primarily to businesses and organizations who use the Internet to receive or send payments. Its corporate office address is 1140 West Pender Street, Suite 1680, Vancouver, British Columbia, Canada. The Corporation links merchants selling products or services to customers wanting to buy them and financial institutions who allow the transfer of payments to occur. The Corporation has partnership arrangements and certified connections to financial institutions, payment processors and other payment service providers in order to enable its customers to safely and reliably conduct e-Commerce. The Corporation provides its electronic payment, authentication and risk management services to over 14,000 businesses and organizations in Canada and the United States of America ("U.S."). The Corporation also provides check processing solutions including primary and secondary check collection including electronic check re-presentment (RCK) to retailers in the U.S.

The Corporation also provides licenses to its intellectual property. The Corporation's intellectual property estate, owned by subsidiary LML Patent Corp., includes U.S. Patent No. 6,354,491, No. 6,283,366, No. 6,164,528, No. 5,484,988, and No. RE40,220, all of which describe electronic check processing methods.

The Corporation is incorporated under the Yukon Business Corporations Act and qualifies as a foreign private issuer in the U.S. for purposes of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). While not required to do so, the Corporation continues to voluntarily report utilizing domestic forms, including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, with the Securities and Exchange Commission ("SEC") instead of filing the reporting forms available to foreign private issuers.

2. Restatement of Comparative Figures

The Corporation has restated its comparative figures for the fiscal year ended March 31, 2012 and the related three month interim periods.

The decision to restate these comparative figures was made by the Corporation's Audit Committee upon management's recommendation following the identification of an error related to the recognition of revenue that occurred during the fiscal year ended March 31, 2012. The error resulted in a non-material misstatement to the Corporation's fiscal 2012 year-end consolidated financial statements which the Corporation has determined will need to be adjusted and presented to the comparative amounts in its interim and annual consolidated financial statements for the fiscal year ended March 31, 2013. The general nature and scope of the related error and adjustments are summarized as follows:

Error in revenue recognition — The Corporation identified an error relating to the recognition of revenue that occurred during the fiscal year ended March 31, 2012 resulting in a non-material misstatement to the fiscal 2012 year-end consolidated financial statements. An analysis of the Corporation's billing report during the three months ended June 30, 2012 resulted in the identification of three customers whereby the accounting of the revenue pertaining to these three customers was erroneous. The three customers receive their monthly invoices independent of the Corporation's automated electronic monthly invoicing systems. The Corporation erroneously recorded to its accounting system revenue from both the electronic invoicing system and the invoices independently sent to these three customers resulting in a duplication of the revenue amounts from these three customers.

As a result of this error, revenue for the fiscal year ended March 31, 2012 was overstated by $300,101 and current income tax expense by $78,027. Net income was also overstated by $222,074 from previously reported net income of $6,727,715 to restated net income of $6,505,641. Basic and diluted earnings per share were overstated by $0.01 per share, from $0.24 and $0.23 respectively to $0.23 and $0.22 respectively. Accounts receivable as at March 31, 2012 was overstated $329,905 while corporate taxes payable and current portion of deferred revenue was overstated $78,437 and $28,268, respectively, with a net understatement of the Corporation's deficit balance at March 31, 2012 of $222,074. For the three months ended June 30, 2011, revenue was overstated by $7,059 and current income tax expense by $1,835, with a net understatement of the Corporation's deficit balance at June 30, 2011 of $5,224.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

2. Restatement of Comparative Figures (continued)

The following tables present the adjustments due to the restatements of the Corporation's previously issued audited consolidated statement of financial position as of March 31, 2012, unaudited consolidated statements of earnings and comprehensive income for the three month period ended June 30, 2011, and unaudited consolidated statements of cash flows for the three month period ended June 30, 2011:

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
AS AT MARCH 31, 2012
(In U.S. Dollars, except as noted below)

	Previously Reported	Adjustments	As restated (unaudited)
ASSETS			
Current Assets			
Cash and cash equivalents	$26,783,754		$26,783,754
Funds held for merchants	9,485,182		9,485,182
Short-term investments	3,290,393		3,290,393
Restricted cash	175,000		175,000
Accounts receivable, less allowance of $27,397	1,602,485	$ (329,905)	1,272,580
Corporate taxes receivable	373,939		373,939
Prepaid expenses	331,361		331,361
Total current assets	42,042,114	(329,905)	41,712,209
Property and equipment, net	121,496		121,496
Patents	120,457		120,457
Restricted cash	258,095		258,095
Deferred tax assets	809,951		809,951
Goodwill	17,874,202		17,874,202
Other intangible assets	3,720,037		3,720,037
Other assets	20,796		20,796
Total assets	$64,967,148	$ (329,905)	$64,637,243
LIABILITIES			
Current Liabilities			
Accounts payable	$720,666		$720,666
Accrued liabilities	1,445,490		1,445,490
Corporate taxes payable	465,044	$ (78,437)	386,607
Funds due to merchants	9,485,182		9,485,182

Current portion of obligations under finance lease	2,460		2,460
Current portion of deferred revenue	1,371,096	(28,268)	1,342,828
Total current liabilities	13,489,938	(106,705)	13,383,233
Obligations under finance lease	4,920		4,920
Total liabilities	13,494,858	(106,705)	13,388,153
EQUITY			
Capital Stock			
Class A, preferred stock, $1.00 CDN par value, 150,000,000 shares authorized, issuable in series, none issued or outstanding	-		-
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, 28,246,684 issued and outstanding	53,918,912		53,918,912
Contributed surplus	10,001,594		10,001,594
Warrants	113,662		113,662
Deficit	(12,835,486)	(222,074)	(13,057,560)
Accumulated other comprehensive income	273,608	(1,126)	272,482
Total equity	51,472,290	(223,200)	51,249,090
Total liabilities and equity	$64,967,148	$ (329,905)	$64,637,243

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

2. Restatement of Comparative Figures (continued)

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED JUNE 30, 2011
(In U.S. Dollars, except share data)
(unaudited)

	Previously Reported	Adjustments	As restated
REVENUE	$5,976,324	$ (7,059)	$5,969,265
COST OF REVENUE	3,321,826		3,321,826
GROSS PROFIT	2,654,498	(7,059)	2,647,439
OPERATING EXPENSES			
General and administrative	931,004		931,004
Sales and marketing	307,510		307,510
Product development and enhancement	273,695		273,695
INCOME BEFORE OTHER INCOME AND INCOME TAXES	1,142,289	(7,059)	1,135,230
Foreign exchange gain	31,650		31,650
Interest income	17,177		17,177
INCOME BEFORE INCOME TAXES	1,191,116	(7,059)	1,184,057
Income tax expense (recovery)			
Current	208,032	(1,835)	206,197
Deferred	290,514		290,514
	498,546	(1,835)	496,711
NET INCOME	692,570	(5,224)	687,346
OTHER COMPREHENSIVE INCOME			
Unrealized foreign exchange gain on translation of foreign operations	14,363		14,363
TOTAL COMPREHENSIVE INCOME	$706,933	$ (5,224)	$701,709
EARNINGS PER SHARE, basic and diluted	$0.02	$ (0.00)	$0.02
WEIGHTED AVERAGE SHARES OUTSTANDING			

Basic	28,149,725	28,149,725
Diluted	28,987,253	28,987,253

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

2. Restatement of Comparative Figures (continued)

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED JUNE 30, 2011
(In U.S. Dollars)
(unaudited)

	Previously Reported	Adjustments	As restated
Operating Activities:			
Net income	$692,570	$ (5,224)	$687,346
Adjustments to reconcile net income to net cash used in operating activities			
Amortization of property and equipment	34,240		34,240
Amortization of intangible assets	165,645		165,645
Share-based payments	136,437		136,437
Deferred income taxes	290,514		290,514
Foreign exchange gain	(3,703)		(3,703)
Changes in non-cash operating working capital			
Accounts receivable	(884,868)	10,318	(874,550)
Corporate taxes receivable	(59,169)		(59,169)
Prepaid expenses	21,507		21,507
Accounts payable and accrued liabilities	(138,024)		(138,024)
Corporate taxes payable	(4,336,920)	(1,835)	(4,338,755)
Deferred revenue	(305,947)	(3,259)	(309,206)
Net cash used in operating activities	(4,387,718)	-	(4,387,718)
Investing Activities:			
Acquisition of property and equipment	(21,242)		(21,242)
Net cash used in investing activities	(21,242)	-	(21,242)
Financing Activities:			
Principal payments on finance leases	-		-
Proceeds from exercise of stock options	205,375		205,375
Net cash provided by financing activities	205,375	-	205,375
Effects of foreign exchange rate changes on cash and cash equivalents	12,387	-	12,387

DECREASE IN CASH AND CASH EQUIVALENTS	(4,191,198)	-	(4,191,198)
Cash and cash equivalents, beginning of period	26,917,491	-	26,917,491
Cash and cash equivalents, end of period	$22,726,293	-	$22,726,293
Supplemental disclosure of cash flow information			
Interest paid	$-		$-
Taxes paid	$4,599,921		$4,599,921

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LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

3. Basis of Presentation

These unaudited interim consolidated financial statements, including comparatives, have been prepared in accordance with International Accounting Standard ("IAS") 34 "Interim Financial Reporting". The accounting policies used in preparing these interim consolidated financial statements are consistent with the accounting policies used in the preparation of the Corporation's annual consolidated financial statements for the year ended March 31, 2012.

These interim consolidated financial statements do not include all disclosures required by International Financial Reporting Standards ("IFRS") for annual consolidated financial statements and, accordingly, should be read in conjunction with the Corporation's audited consolidated financial statements for the year ended March 31, 2012 presented under IFRS. The results for the three months ended June 30, 2012 may not be indicative of the results that may be expected for the full fiscal year or any other period.

The interim consolidated financial statements are presented in United States Dollars, except when otherwise indicated.

These consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries as set out below. All significant inter-company balances and transactions have been eliminated on consolidation.

CANADA	UNITED STATES
Legacy Promotions Inc.	LML Corp.
Beanstream Internet Commerce Inc. ("Beanstream")	LML Patent Corp.
	LML Payment Systems Corp.
	Beanstream Internet Commerce Corp.

4. Significant Accounting Policies

(a) Inventory

The Corporation's inventory is comprised of credit card magnetic stripe readers used to communicate with mobile devices. Inventory is recorded at the lower of cost and net realizable value. The cost of inventory is comprised of purchase costs and costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated selling costs.

(b) New standards and interpretations not yet adopted

Standards issued but not yet effective up to the date of issuance of the Corporation's consolidated financial statements are listed below. This listing is of standards and interpretations issued which the Corporation reasonably expects to be applicable at a future date. The Corporation intends to adopt those standards when they become effective. The Corporation has yet to assess the full impact of these standards on the interim consolidated financial statements.

IFRS 9 - Financial Instrument: Classification and Measurement

IFRS 9 was issued in November 2009. This standard is the first step in the process to replace IAS 39 Financial Instruments: Recognition and Measurements. IFRS 9 introduces new requirements for classifying and measuring assets and liabilities, which may affect the Corporation's accounting for its financial instruments. The standard is not applicable until annual periods beginning on or after January 1, 2015 but is available for early adoption, however, the Corporation does not currently intend to early adopt this standard.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

4. Significant Accounting Policies (continued)

IFRS 10 - Consolidated Financial Statements

The Corporation will be required to adopt IFRS 10 Consolidated Financial Statements ("IFRS 10") effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. IFRS 10 replaces the consolidation requirements in IAS 27 Consolidated and Separate Financial Statements ("IAS 27") and interpretation SIC-12 Consolidation—Special Purpose Entities ("SIC-12"). IFRS 10 provides a revised definition of control and related application guidance so that a single control model can be applied to all entities. IFRS 10 also enhances disclosures about consolidated and unconsolidated entities to be published in a separate comprehensive disclosure standard related to involvement in other entities. The Corporation has not early adopted this standard.

IFRS 12 - Disclosure of Interests in Other Entities

IFRS 12 provides the required disclosures for interests in subsidiaries and joint arrangements. These disclosures will require information that will assist users of financial statements to evaluate the nature, risks and financial effects associated with an entity's interests in subsidiaries and joint arrangements. This standard is not applicable until annual periods beginning on or after January 1, 2013.

IFRS 13 – Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurement and in many cases does not reflect a clear measurement basis or consistent disclosures. This standard is not applicable until annual periods beginning on or after January 1, 2013.

IAS 1 Financial Statement Presentation

The Corporation will be required to adopt the amendments to IAS 1 Financial Statement Presentation ("IAS 1") effective for annual periods beginning on or after July 1, 2012. These amendments improve the presentation of components of other comprehensive income ("OCI"). The amendments to this standard do not change the nature of the items that are currently recognized in OCI, but requires presentational changes.

5. Financial Instruments

(a) The Corporation classifies its cash and cash equivalents, funds held for merchants, short-term investments, restricted cash and accounts receivable as loans and receivables measured at amortized cost using the effective interest rate method. Accounts payable, certain accrued liabilities and funds due to merchants are classified as other financial liabilities measured at amortized cost using the effective interest rate method.

The carrying value of the Corporation’s financial assets and liabilities is considered to be a reasonable approximation of fair value due to their immediate or short term maturity or their ability for liquidation at comparable amounts.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

5. Financial Instruments (Continued)

Carrying value and fair value of financial assets and liabilities as at June 30, 3012 and March 31, 2012 are summarized as follows:

	June 30, 2012		March 31, 2012 (As restated – Note 2)	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Loans and receivables	$45,610,007	$45,610,007	$41,265,004	$41,265,004
Other financial liabilities	$15,042,027	$15,042,027	$11,651,338	$11,651,338

(b) Restricted cash

Under the terms of the processing agreement with one of the Corporation's processing banks, the Corporation pledged a deposit of $175,000 (March 31, 2012 - $175,000) against charge back losses. Non-current restricted cash represents funds held by a third party processor as security for the Corporation's merchant accounts.

(c) Market Risk

Currency Risk

The Corporation's functional currency is the U.S. dollar except for the Corporation's Canadian Beanstream subsidiary whose functional currency is the Canadian dollar. Movements in the foreign currency exchange rate between the Canadian and U.S. dollar will give rise to gains and losses to the Corporation due to the existence of cash balances and other monetary assets and liabilities denominated in a currency other than the functional currency of each entity within the consolidated group. Significant losses may occur due to significant balances of cash and cash equivalents and short-term investments held in Canadian dollars (U.S. dollars for Beanstream) that may be affected negatively by an increase in the value of the U.S. dollar as compared to the Canadian dollar (Canadian dollar as compared to the U.S. dollar for Beanstream). The Corporation has not hedged its exposure to foreign currency fluctuations.

As at June 30, 2012 and March 31, 2012, the Corporation is exposed to currency risk through its cash and cash equivalents, restricted cash, funds held for merchants, accounts receivable, accounts payable, accrued liabilities, and funds due to merchants denominated in Canadian dollars (U.S. dollars for Beanstream).

Based on the foreign currency exposure as at June 30, 2012 and March 31, 2012 and assuming all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the U.S. dollar would result in an increase/decrease of $186,531 and $88,613, respectively, in the Corporation's foreign currency loss/gain.

As at June 30, 2012 and March 31, 2012 the Corporation's Canadian Beanstream subsidiary was exposed to currency risk on the translation of its financial instruments to U.S. dollars. Beanstream's financial instruments are translated into U.S. dollars at rates of exchange in effect at the balance sheet date. Gains and losses arising on the translation of Beanstream's financial instruments are reported as a cumulative translation adjustment which is a component of accumulated other comprehensive income. Based on the foreign currency exposure as at June 30, 2012 and March 31, 2012 and assuming all other variables remain constant, a 10% depreciation or appreciation of the Canadian dollar against the U.S. dollar would result in an increase/decrease of $367,382 and $212,574, respectively, in the Corporation's other comprehensive income.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

5. Financial Instruments (continued)

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Corporation's exposure to interest rate risk is limited as its cash and payment processing accounts earn minimal interest.

Other Price Risk

Other price risk is the risk that the future value or cash flows of a financial instrument will fluctuate because of changes in market prices. Exposure to price risk is low as the Corporation's cash management policy is to invest excess cash in high grade/low risk investments over short periods of time.

(d) Credit Risk

Credit risk is the risk of a financial loss if a customer or counter party to a financial instrument fails to meet its contractual obligations. Any credit risk exposure on cash balances is considered negligible as the Corporation places funds or deposits only with major established banks in the countries in which it has payment processing services. The credit risk arises primarily from the Corporation's trade receivables from customers.

On a regular basis, the Corporation reviews the collectability of its trade accounts receivable and establishes an allowance for doubtful accounts based on its best estimates of any potentially uncollectible accounts. As at June 30, 2012, the balance of the Corporation's allowance for doubtful accounts was $26,867 (March 31, 2012 - $27,397). The Corporation has good credit history with its customers and the amounts due from them are usually received as expected.

Pursuant to their respective terms, gross accounts receivable are aged as follows at June 30, 2012:

0-30 days	$1,262,155
31-60 days	-
61-90 days	11,551
Over 90 days due	181,391
	$1,455,097

Concentration of credit risk

Financial instruments that potentially subject the Corporation and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments and accounts receivable.

Cash and cash equivalents and short-term investments are invested in major financial institutions in the U.S. and Canada. Such deposits may be in excess of insured limits and are not insured in other jurisdictions. Management believes that the financial institutions that hold the Corporation's investments are financially sound and, accordingly, relatively minimal credit risk exists with respect to these investments.

The accounts receivable of the Corporation and its subsidiaries are derived from sales to customers located primarily in the U.S. and Canada. The Corporation performs ongoing credit evaluations of its customers. The Corporation generally does not require collateral.

An allowance for doubtful accounts is determined with respect to those amounts that the Corporation has determined to be doubtful of collection. At June 30, 2012, three customers accounted for 19%, 10% and 10% of the Corporation's accounts receivable balance (March 31, 2012 – 21%, 11%, and 5%).

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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5. Financial Instruments (continued)

(e) Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due. The Corporation continuously monitors actual and forecasted cash flows to ensure, as far as possible, there is sufficient working capital to satisfy its operating requirements.

	June 30, 2012				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Contractual Obligations, at June 30, 2012					
Accounts payable and accrued liabilities	$2,087,876	$2,087,876	$-	$-	$-
Funds due to merchants	12,954,151	12,954,151	-	-	-
Capital lease obligations	6,585	2,460	4,125	-	-
Total	$15,048,612	$15,044,487	$4,125	$-	$-

	March 31, 2012				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Contractual Obligations, at March 31, 2012					
Accounts payable and accrued liabilities	$2,166,156	$2,166,156	$-	$-	$-
Funds due to merchants	9,485,182	9,485,182	-	-	-
Capital lease obligations	7,380	2,460	4,920	-	-
Total	$11,658,718	$11,653,798	$4,920	$-	$-

6. Related Party Transactions

Compensation of key management personnel for the three month periods ended June 30, 2012 and 2011 are as follows:

	Three month period ended	
	June 30, 2012	June 30, 2011
Short-term employee benefits	$194,027	$157,105
Share-based payments	113,696	70,695
Total	$307,723	$227,800

The amounts disclosed in the table are the amounts recognized as an expense during the reporting period related to key management personnel.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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7. Income Taxes

At June 30, 2012, the Corporation had Canadian non-capital loss carry-forwards for income tax purposes of approximately $482,180 expiring in 2033. Due to Canadian and U.S. tax "change of ownership" rules, the loss carry-forwards are restricted in their use.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Corporation's deferred tax assets as of June 30, 2012 and March 31, 2012 are as follows:

	June 30, 2012	March 31, 2012
Deferred tax assets:		
Excess of tax value over the net book value for capital assets	$573,434	$612,680
Canadian non-capital loss carry-forwards	120,545	39,922
Other	161,694	157,349
Total deferred tax assets	$855,673	$809,951

The reconciliation of income tax attributable to operations computed at the statutory tax rates to income tax expense (recovery), using an approximate 25% statutory tax rate at June 30, 2012 and an approximate 26% statutory tax rate at June 30, 2011, is as follows:

	June 30, 2012	June 30, 2011 (As restated – Note 2)
Income taxes at statutory rates	$244,792	$299,826
Share-based payments and other permanent differences	74,838	83,321
Effect of U.S. tax rates	74,884	118,014
Effect of foreign exchange translation of foreign currency denominated deferred income tax assets	-	2,369
Effect of change in tax rates and other	15,383	(6,819)
	$409,897	$496,711

During the Corporation's assessment of the realizability of its deferred tax assets, the Corporation considered all available positive and negative evidence including its past operating results, the existence of cumulative losses and its forecast of future taxable income. In determining future taxable income, the Corporation is responsible for assumptions utilized including the amount of pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment about the forecasts of future taxable income and are consistent with the plans and estimates it uses to manage the underlying businesses.

8. Commitments and Contingencies

Reexamination Proceedings

On May 11, 2010, four of the defendants (the “Third Party Requesters”) in the patent litigation commenced by a subsidiary of the Corporation in 2008 (which has since been resolved and is now closed) submitted a request for an inter-partes reexamination to the United States Patent and Trademark Office (“USPTO”) regarding the Corporation’s U.S. Patent No. RE40,220 (the “40,220 Patent”). Prior to the Corporation’s fiscal year ended March 31, 2012, the USPTO rejected 16 of the 100 claims described by the 40,220 Patent. The rejected claims continue to be subject to re-examination; however, they will remain valid and enforceable until the 40,220 Patent expires on January 16, 2013 unless they are cancelled prior to that date. During the three months ended June 30, 2012, there were no material developments relating to the inter-partes proceeding.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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8. Commitments and Contingencies (continued)

In response (in part) to the inter-partes reexamination proceeding, on June 17, 2011, the subsidiary of the Corporation filed a separate ex-parte reexamination request with the USPTO with respect to other claims described in the 40,220 Patent. As part of this request, the subsidiary of the Corporation requested amendments to certain claims and also requested the addition of new claims and the cancellation of certain claims described in the 40,220 Patent. On September 13, 2011, the USPTO issued an order granting an ex-partes reexamination with respect to the 40,220 Patent. On January 4, 2012, the USPTO issued a non-final office action in the ex-parte reexamination proceeding pursuant to which: (i) certain claims described by the 40,220 Patent were subject to reexamination; (ii) certain other claims were cancelled (as the subsidiary of the Corporation requested); (iii) certain other claims were rejected, and (iv) new claims were added. Following the February 1, 2012 response of the subsidiary of the Corporation and an examiner interview, the USPTO issued a Notice of Intent to Issue a Reexam Certificate on March 20, 2012. On May 2, 2012 the USPTO issued an Ex-Parte Reexamination Certificate in the ex-parte reexamination proceeding. On the Certificate, certain amended and added claims were confirmed and other claims were cancelled, as the subsidiary of the Corporation had requested in its originally filed ex-parte reexamination request. As a result of the issuance of the Ex-Parte Reexamination Certificate, the ex-parte reexamination proceeding is closed. The Third Party Requesters did not have the right to participate in the ex-parte reexamination proceeding.

9. Industry and Geographic Segments

Based upon the way financial information is provided to the Corporation's Chief Executive Officer for use in evaluating allocation of resources and assessing performance of the business, the Corporation reports its operations in three distinct operating segments, described as follows:

Transaction Payment Processing ("TPP") operations involve financial payment processing, authentication and risk management services provided by Beanstream. The services are accessible via the Internet and are offered in an application service provider (ASP) model.

Intellectual Property Licensing ("IPL") operations involve licensing an intellectual property estate, which includes five U.S. patents describing electronic check processing methods.

Check Processing ("CP") operations involve primary and secondary check collection including electronic check re-presentment ("RCK").

Within these segments, performance is measured based on revenue, factoring in interest income and expenses and amortization and depreciation as well as income before income taxes from each segment. There are no transactions between segments. The Corporation does not generally allocate corporate or centralized marketing and general and administrative expenses to its business unit segments because these activities are managed separately from the business units.

LML PAYMENT SYSTEMS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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9. Industry and Geographic Segments (continued)

Financial information for each reportable segment for the three months ended June 30, 2012 and 2011 is as follows:

Three Months Ended June 30, 2012	TPP Canada	IPL U.S.	CP U.S.	Reconciling Items		Consolidated Total	
Total revenue	$4,620,767	$424,119	$568,146	$-		$ 5,613,032	
Revenue: major customers	-	305,556	377,158	-		682,714	
Cost of revenue	2,883,208	535	327,546	29,013	1	3,240,302	5
General and administrative	213,347	8,011	99,539	595,075	2	915,972	5
Sales and marketing	146,206	-	4,433	-	1	150,639	5
Product development and enhancement	261,329	-	-	19,446	1	280,775	5
Amortization and depreciation	14,993	44,682	6,858	124,136	3	190,669	5
Income (losses) before income taxes	1,200,577	373,634	130,383	(847,368)	4	857,226	

Three Months Ended June 30, 2011 (As Restated – Note 2)	TPP Canada	IPL U.S.	CP U.S.	Reconciling Items		Consolidated Total	
Total revenue	$3,678,793	$1,681,548	$608,924	$-		$ 5,969,265	
Revenue: major customers	528,359	1,250,000	374,178	-		2,152,537	
Cost of revenue	2,219,626	683,248	392,741	10,916	1	3,306,531	5
General and administrative	228,946	11,279	99,734	538,626	2	878,585	5
Sales and marketing	197,619	-	4,354	3,639	1	205,612	5
Product development and enhancement	234,689	-	-	8,733	1	243,422	5
	20,961	41,855	10,007	127,062	3	199,885	5

Amortization and depreciation						
Income (losses) before income taxes	802,797	948,601	103,308	(670,649)	4	1,184,057

1 Represents share-based payments included in the unallocated corporate or centralized marketing, general and administrative expenses.
2 Represents share-based payments and other unallocated corporate or centralized marketing, general and administrative expenses.
3 Represents amortization and depreciation included in the unallocated corporate or centralized marketing, general and administrative expenses.
4 Represents income (losses) included in the unallocated corporate or centralized marketing, general and administrative expenses.
5 Amortization of property and equipment has not been allocated to other cost categories as presented in the consolidated statements of earnings and comprehensive income.

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 "ou refer to LML Payment Systems Inc. and its direct and indirect subsidiaries. LML Payment Systems Inc.'s direct subsidiaries include Beanstream Internet Commerce Inc., LML Corp. and Legacy Promotions Inc. LML Corp.'s subsidiaries are LML Patent Corp., LML Payment Systems Corp. and Beanstream Internet Commerce Corp. Unless otherwise specified herein, all references herein to dollars or "$" are to U.S. Dollars.

We are incorporated under the Yukon Business Corporations Act and qualify as a foreign private issuer in the U.S. for purposes of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). While not required to do so, we continue to voluntarily report utilizing domestic forms, including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, with the Securities and Exchange Commission ("SEC") instead of filing the reporting forms available to foreign private issuers.

The following discussion and analysis should be read in conjunction with the unaudited interim consolidated financial statements and related notes thereto for the three months ended June 30, 2012 included therein, which have been prepared in accordance with IFRS as issued by the IASB. 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 renewal of material contracts in our business, our ability to anticipate and respond to technological changes, particularly with respect to financial payments and eCommerce, 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 and 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

We are a financial payment processor operating three separate lines of business: transaction payment processing, intellectual property licensing and check processing. Our transaction payment processing services consist predominantly of Internet-based services, while our check processing services involve predominantly traditional and electronic check processing and recovery services that do not utilize the Internet. While we have historically generated significant amounts of non-recurring revenue associated with our intellectual property licensing initiatives (see “—Resolution of Patent Infringement Litigation” below), our transaction payment processing services are (and are expected to be for the foreseeable future) our principal line of business, while our other lines of business (including our electronic check processing services and intellectual property licensing initiatives) are less significant to the financial performance of our company.

Resolution of Patent Infringement Litigation

On November 19, 2008, we filed a patent infringement lawsuit in the U.S. district court for the Eastern District of Texas against multiple financial institutions operating in the United States (the “2008 Patent Litigation”). On June 4, 2009, we filed another patent infringement lawsuit in the U.S. district court for the Eastern District of Texas against six financial institutions operating in the United States (the “2009 Patent Litigation”). In both patent infringement lawsuits, we alleged that the defendants were infringing our 40,220 Patent. During our fiscal year ended March 31, 2012, we settled with (and/or dismissed our claims against) the last of the defendants in both the 2008 Patent Litigation and the 2009 Patent Litigation. As a result, both lawsuits were closed during our 2012 fiscal year and we are not currently prosecuting any patent infringement claims against any parties.

Our primary source of revenue from our IPL segment operations for our fiscal years ended 2011 and 2012 was from revenue generated from the licensing and settlement agreements that we entered into in connection with our 2008 Patent Litigation and, to a lesser extent, our 2009 Patent Litigation. Since both of those lawsuits have been closed and since the 40,220 Patent expires in January 2013, we expect a decline for the foreseeable future (starting with our 2013 fiscal year) in the number of new licensing agreements that we will enter into and, accordingly, we expect that the revenue generated in upcoming years from the licensing of our intellectual property estate will be substantially reduced from recent historical levels. While the revenue derived in future periods from the licensing of our intellectual property estate may fluctuate significantly from time to time, we generally expect that going forward the revenue from our IPL segment operations will continue to be less significant to the overall financial performance of our company.

TPP Segment

Our TPP segment operations involve financial payment processing, authentication and risk management services. We provide a service that acts as a bank neutral interface between businesses and consumers processing financial or authentication transactions. Our transaction payment processing services are accessible via the Internet and are offered in an application service provider (ASP) model. We focus on product development, project management and third tier technical support of our products and services and rely primarily on strategic business partners to sell and market our products and services. In some instances, our transaction payment processing services and payment products are integrated into third party products in target vertical markets. Our revenues are derived from one-time set-up fees, monthly gateway fees, and transaction fees paid to us by merchants. Transaction fees are recognized in the period in which the transaction occurs. Gateway fees are monthly subscription fees charged to our merchant customers for the use of our payment gateway and are recognized in the period in which the service is provided. Set-up fees represent one-time charges for initiating our processing services. Although these fees are generally paid at the commencement of the agreement, they are recognized ratably over the estimated average life of the merchant relationship, which is determined through a series of analyses of active and deactivated merchants. We currently service a merchant base of over 14,000 customers primarily in Canada.

IPL Segment

Our IPL segment operations involve licensing our intellectual property estate, which includes five U.S. patents describing electronic check processing methods. Licenses to our intellectual property estate are generally provided to licensees based on usage of the technology embodied in the patent(s) being licensed. Some licensees pay ‘running royalties,’ which is a pay-as-you-go model, and other licensees pay a ‘one-time,’ fully paid-up royalty amount, also based on usage. Licensees’ usage pertaining to these one-time, fully paid-up licenses is contractually determined and in some cases, in order to determine usage and to facilitate the negotiation of a license agreement, the commencement of litigation and the discovery process inherent therein (to determine usage), is employed. These one-time, fully paid-up licenses are also non-exclusive, similar to the non-exclusive nature of many software licensing arrangements treated as product sales, and the consideration is fixed and non-refundable with no trailing royalties or other variable consideration. Since our 40,220 Patent (which is the primary patent that has generated IPL revenue for us in recent years) is set to expire in January 2013, we expect a decline for the foreseeable future (starting with our 2013 fiscal year) in the number of new licensing agreements that we will enter into. Accordingly, we expect that the revenue generated in upcoming years from the licensing of our intellectual property estate will be substantially reduced from recent historical levels and expect that our IPL segment operations will continue to be less significant to the overall financial performance of our company.

CP Segment

Our CP segment operations involve primary and secondary check collection including electronic check re-presentment (RCK). Our check processing services involve return check management such as traditional and electronic recovery services to retail clients wherein we typically receive revenue when we are successful at recovering the principal amount of the original transaction on behalf of the client. In some instances we also earn a percentage of the principal amount and in other instances our secondary recovery services provide for us to earn additional fees when legal action is required. Our check processing services are provided in the United States and are operated from our Wichita, Kansas location.

Within these segments, performance is measured based on revenue, factoring in interest income and expenses, amortization and depreciation, and earnings from operations before income taxes from each segment. There are no transactions between segments. We do not generally allocate corporate or centralized marketing and general and administrative expenses to our business unit segments because these activities are managed separately from the business units.

Results of Operations

We qualify as a foreign private issuer in the U.S. for purposes of the Exchange Act. As such, we file our consolidated financial statements with the Securities and Exchange Commission ("SEC") under IFRS without a reconciliation to generally accepted accounting principles in the U.S. ("U.S. GAAP"). It is possible that certain of our accounting policies under IFRS could be different from U.S. GAAP.

Three months ended June 30, 2012 compared to three months ended June 30, 2011

	Three months ended June 30,		Variance	
	2012	2011	$	%
Revenue	$5,613,000	$5,969,000	(356,000)	(6.0)
Costs of revenue	3,251,000	3,322,000	(71,000)	(2.1)
Gross profit	2,362,000	2,647,000	(285,000)	(10.8)
Operating expenses				
General and administrative	966,000	931,000	35,000	3.8
Sales and marketing	251,000	307,000	(56,000)	(18.2)
Product development and enhancement	310,000	274,000	36,000	13.1
Income before other income (expenses) and income taxes	835,000	1,135,000	(300,000)	(26.4)
Foreign exchange (loss) gain	(4,000)	32,000	(36,000)	(112.5)
Interest income	27,000	17,000	10,000	58.8
Income before income taxes	858,000	1,184,000	(326,000)	(27.5)
Income tax expense				
Current	456,000	206,000	250,000	121.4
Deferred	(46,000)	291,000	(337,000)	(115.8)
	410,000	497,000	(87,000)	(17.5)
Net income	$448,000	$687,000	(239,000)	(34.8)

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Revenue

The following table compares the revenue generated by all three of our business segments during the three months ended June 30, 2012 and 2011:

	Three months ended June 30,		Variance	
	2012	2011	$	%
Revenue				
TPP Segment:				
Transaction fees	$3,791,000	$2,925,000	866,000	29.6
One-time set-up fees recognized	65,000	55,000	10,000	18.2
Monthly fees including gateway	630,000	489,000	141,000	28.8
Software customization fees	18,000	134,000	(116,000)	(86.6)
Other	117,000	76,000	41,000	53.9
	4,621,000	3,679,000	942,000	25.6
IPL Segment:				
Non-recurring licensing	-	1,250,000	(1,250,000)	-
Ongoing/Recognized deferred	424,000	431,000	(7,000)	(1.6)
	424,000	1,681,000	(1,257,000)	(74.8)
CP Segment:				
Secondary check collections	489,000	529,000	(40,000)	(7.6)
Primary check collections	76,000	76,000	-	-
Other	3,000	4,000	(1,000)	(25.0)
	568,000	609,000	(41,000)	(6.7)
Total revenue	$5,613,000	$5,969,000	(356,000)	(6.0)

The decrease is total revenue for the three months ended June 30, 2012 is primarily attributable to the decrease in our non-recurring IPL segment revenue of approximately $1,250,000 offset by an increase in our TPP segment revenue of approximately $942,000.

TPP Segment

Revenue pertaining to our TPP segment consists of transaction fees, one-time set-up fees, monthly fees including gateway fees and software customization fees. Total revenue from our TPP segment increased by approximately $942,000, or approximately 25.6%. Transaction fees for the three months ended June 30, 2012 increased by approximately $866,000 or approximately 29.6%; the amortized portion of one-time setup fees recognized increased approximately $10,000 or approximately 18.2%; monthly fees including gateway fees for the three months ended June 30, 2012 increased approximately $141,000 or approximately 28.8% while software customization fees decreased approximately $116,000 or approximately 86.6%. The increase in transaction fees, one-time set-up fees and monthly fees including gateway fees was primarily attributable to a 26.8% increase in our merchant base as at June 30, 2012 as compared to June 30, 2011.

IPL Segment

Revenue from licensing our patented intellectual property decreased by approximately $1,257,000 or approximately 74.8% primarily due to the recognition of approximately $1,250,000 in non-recurring revenue from a license agreement entered into during the three months ended June 30, 2011.

CP Segment

CP segment revenue for the three months ended June 30, 2012 decreased by approximately $41,000 or approximately 6.7% primarily due to a decrease in collections of the principal amount and related fees of returned checks assigned for primary and secondary recovery.

Cost of Revenue

The following table compares the cost of revenue incurred by all three of our business segments during the three months ended June 30, 2012 and 2011:

	Three months ended June 30,		Variance	
	2012	2011	$	%
Cost of revenue				
TPP Segment	$2,883,000	$2,220,000	663,000	29.8
IPL Segment	-	683,000	(683,000)	-
CP Segment	328,000	393,000	(65,000)	(16.5)
Share-based payments	29,000	11,000	18,000	163.6
Depreciation of property and equipment	11,000	15,000	(4,000)	(26.7)
Total	$3,251,000	$3,322,000	(71,000)	(2.1)

Cost of revenue consists primarily of costs incurred by the TPP, IPL and CP operating segments. Within our TPP segment, these costs are incurred in the delivery of electronic payment transaction services and customer service support and include processing and interchange fees paid, other third-party fees, personnel costs and associated benefits. IPL segment costs of revenue are primarily legal retention fees and legal disbursement costs incurred in generating licensing revenue. CP segment costs of revenue are primarily incurred in the delivery of check collection services and include third-party fees, personnel costs and associated benefits.

Costs of revenue decreased for the three months ended June 30, 2012 by approximately $71,000 or approximately 2.1%. This decrease was primarily attributable to a decrease of approximately $683,000 in IPL segment cost of revenue offset by an increase in TPP segment cost of revenue of approximately $663,000. The decrease in IPL segment costs was primarily due to a decrease of approximately $610,000 in the costs (primarily legal costs) incurred in connection with a license agreement entered into during the three months ended June 30, 2011. The increase in TPP segment costs was primarily attributable to an increase of approximately 35.6% in our transaction costs which include interchange, assessments and other transaction fees which coincided with increased transaction processing revenue. CP segment cost of revenue decreased approximately $65,000 or approximately 16.5% which coincided with the decrease in CP segment revenue for the three months ended June 30, 2012.

General and administrative expenses

The following table compares general and administrative expenses incurred by all three of our business segments as well as our corporate and support functions during the three months ended June 30, 2012 and 2011:

	Three months ended June 30,		Variance	
	2012	2011	$	%
General and administrative expenses				
TPP Segment	$213,000	$229,000	(16,000)	(7.0)
IPL Segment	8,000	11,000	(3,000)	(27.3)
CP Segment	100,000	100,000	-	-
Share-based payments	151,000	113,000	38,000	33.6

Depreciation of property and equipment	6,000	11,000	(5,000)	(45.5)
Amortization of patents	45,000	42,000	3,000	7.1
Other unallocated general and administrative expenses	443,000	425,000	18,000	4.2
Total	$966,000	$931,000	35,000	3.8

General and administrative expenses consist primarily of personnel costs including associated share-based payments and employment benefits, office facilities, travel, public relations and professional service fees, which include legal fees, audit fees and SEC and related compliance costs. General and administrative expenses also include the costs of corporate and support functions including our executive leadership and administration groups, finance, information technology, legal, human resources and corporate communication costs.

General and administrative expenses increased approximately $35,000 or approximately 3.8% for the three months ended June 30, 2012. The increase was primarily attributable to an increase in share-based payments of approximately $38,000 or approximately 33.6%. TPP segment general and administrative expenses decreased approximately $16,000 or approximately 7% primarily due to a decrease in wages and benefits of approximately $28,000.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries paid to sales staff, sales commissions, sales operations and other personnel-related expenses, travel and related expenses, trade shows, costs of lead generation, consulting fees and costs of marketing programs, such as internet, print and direct mail advertising costs. Sales and marketing expenses also include the amortization expense for partner relationships and merchant contracts.

Sales and marketing expenses decreased to approximately $251,000 from approximately $308,000 for the three months ended June 30, 2012 and 2011, respectively, a decrease of approximately $57,000 or approximately 18.5%. The decrease is primarily attributable to a decrease in TPP segment sales and marketing expenses of approximately $52,000 or approximately 26.3% from approximately $198,000 for the three months ended June 30, 2011 to approximately $146,000 for the three months ended June 30, 2012. The decrease in TPP segment sales and marketing expenses is primarily attributable to a decrease in wages and commissions of approximately $33,000, resulting from lower compensation costs for the three months ended June 30, 2012 as compared to the three months ended June 30, 2011. Amortization expense for partner relationships and merchant contracts were approximately $97,000 for the three months ended June 30, 2012 and 2011 respectively.

Product Development and Enhancement

Product development and enhancement expenses consist primarily of compensation and related costs of employees engaged in the research, design and development of new services and in the improvement and enhancement of the existing product and service lines. Product development and enhancement expenses also include the amortization expense for existing technology.

Product development and enhancement expenses were approximately $310,000 for the three months ended June 30, 2012 as compared to approximately $274,000 for the three months ended June 30, 2011, an increase of approximately $36,000 or approximately 13.1%. The increase is primarily attributable to an increase in TPP segment product development and enhancement expenses of approximately $26,000 or approximately 11.1% from approximately $235,000 for the three months ended June 30, 2011 to approximately $261,000 for the three months ended June 30, 2012. The increase in TPP product development and enhancement expenses is primarily attributable to an increase in compensation costs of approximately $23,000 for the three months ended June 30, 2012 as compared to the three months ended June 30, 2011. Amortization expense for existing technology was approximately $27,000 for each of the three months ended June 30, 2012 and 2011.

Interest Income

Interest income increased to approximately $27,000 from approximately $17,000 for the three months ended June 30, 2012 and 2011, respectively. The increase in interest income was primarily attributable to an increase in interest bearing cash investments.

Income Tax Expense (recovery)

Income tax expense (recovery) consists of current income taxes of approximately $456,000 for the three months ended June 30, 2012 compared to approximately $206,000 for the three months ended June 30, 2011, an increase in current income tax expense of approximately $250,000. The increase in current income tax expense is primarily attributable to the utilization of certain tax loss carry-forwards against the taxable income of Beanstream during the prior fiscal three months ended June 30, 2011. There were no loss carry-forwards available to offset the taxable income of Beanstream during the current fiscal three months ended June 30, 2012. Deferred income tax recovery was approximately $46,000 for the three months ended June 30, 2012 compared to deferred income tax expense of approximately $291,000 for the three months ended June 30, 2011, a decrease in deferred income tax expense of approximately $337,000. The decrease in deferred income tax expense was primarily attributable to an increase in our Canadian non-capital loss carry-forwards of approximately $332,000 for the three months ended June 30, 2012 resulting in an increase in our deferred tax asset balance as at June 30, 2012.

Net Income

Net income decreased approximately $240,000 from approximately $687,000 for the three months ended June 30, 2011 to approximately $447,000 for the three months ended June 30, 2012.

Basic and diluted earnings per share were both approximately $0.02 for the three months ended June 30, 2012 and 2011, respectively.

Liquidity and Capital Resources

Our liquidity and financial position consisted of approximately $28,968,000 in working capital as of June 30, 2012 compared to approximately $28,329,000 in working capital as of March 31, 2012, an increase of approximately $639,000. The increase in working capital was primarily attributable to an increase in cash and cash equivalents of approximately $777,000 for the three months ended June 30, 2012. Cash provided by operating activities was approximately $947,000 for the three months ended June 30, 2012, as compared to cash used in operating activities of approximately $4,388,000 for the three months ended June 30, 2011, an increase of approximately $5,335,000. The increase in cash provided by operating activities was primarily attributable to corporate tax payments made of approximately $NIL for the three months ended June 30, 2012 as compared to corporate tax payments made of approximately $4,600,000 for the three months ended June 30, 2011. Cash used in investing activities was approximately $27,000 for the three months ended June 30, 2012 as compared to approximately $21,000 for the three months ended June 30, 2011, an increase in cash used in investing activities of approximately $6,000. The increase in cash used in investing activities was primarily attributable to an increase in acquisition of property and equipment of approximately $6,000 for the three months ended June 30, 2012 as compared to the three months ended June 30, 2011. Cash provided by financing activities was approximately $NIL for the three months ended June 30, 2012 as compared to cash provided by financing activities of approximately $205,000 for the three months ended June 30, 2011, a decrease in cash provided by financing activities of approximately $205,000. The decrease in cash provided by financing activities was primarily attributable to proceeds from exercise of stock options of approximately $205,000 during the three months ended June 30, 2011. No stock options were exercised during the three months ended June 30, 2012.

Management tracks projected cash collections and projected cash outflows to monitor short-term liquidity requirements and to make decisions about future resource allocations and take actions to adjust our expenses with the goal of remaining cash flow positive from operations on an annual basis. We believe that, as of June 30, 2012, the Corporation’s cash resources will be sufficient to meet our operating requirements for the next twelve months.

In light of our strategic objective of acquiring electronic payment volume across all our financial payment processing services and strengthening our position as a financial payment processor, our long-term plans may include the potential to strategically acquire complementary businesses, products or technologies and may also include instituting actions against other entities who we believe are infringing our intellectual property. While we believe that existing cash and cash equivalent balances and potential cash flows from operations should satisfy our long-term cash requirements, we may nonetheless have to raise additional funds for these purposes, either through equity or debt financing, as appropriate. 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, 2012. For a description of our critical accounting policies, see our Annual Report on Form 10-K for the year ended March 31, 2012 filed with the Securities and Exchange Commission on June 20, 2012 (file no. 000-13959):

Contingencies

See Note 8. Commitments and Contingencies, for a discussion of contingencies.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

From March 31, 2012 until June 30, 2012, 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, 2012, as filed with the Securities and Exchange Commission on June 20, 2012 (file no. 000-13959).

ITEMCONTROLS AND PROCEDURES
4.

Evaluation of Disclosure Controls and Procedures. As required by Rule 13a-15(b) under the Securities and Exchange Act of 1934, as amended, (the "Exchange Act"), our management, including our Chief Executive Officer ("CEO") and Chief Accounting Officer ("CAO"), carried out an evaluation of the effectiveness of the design and operation of our "disclosure controls and procedures" as of the end of the period covered by this report. As defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, disclosure controls and procedures are controls and other procedures of our Corporation that are designed to ensure that information required to be disclosed by our Corporation in the reports we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by our Corporation in the reports we file or submit under the Exchange Act is accumulated and communicated to our Corporation's management, including our CEO and CAO, as appropriate, to allow timely decisions regarding required disclosure.

Based on their evaluation, our CEO and CAO concluded that, our disclosure controls and procedures were effectively designed to provide reasonable assurance that information required to be disclosed by our Corporation in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and to provide reasonable assurance that such information is accumulated and communicated to our Corporation's management, including our CEO and CAO, as appropriate, to allow timely decisions regarding required disclosure. Based on their evaluation, our CEO and CAO also concluded that our disclosure controls and procedures were operating effectively at the reasonable assurance level. It should be noted that any system of controls, however well designed and operated, is based in part upon certain assumptions and can provide only reasonable, and not absolute, assurance that the objectives of the system are met.

Changes in Internal Control over Financial Reporting. As required by Rule 13a-15(d) under the Exchange Act, our management, including our CEO and CAO, also conducted an evaluation of our internal control over financial reporting to determine whether any change occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Based on our evaluation, during our most recent fiscal quarter there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Reexamination Proceedings

On May 11, 2010, four of the defendants (the "Third Party Requesters") in the patent litigation that we commenced in 2008 (which has since been resolved and is now closed) submitted a request for an inter-partes reexamination to the USPTO regarding our 40,220 Patent. Prior to our fiscal year ended March 31, 2012, the USPTO rejected 16 of the 100 claims described by the 40,220 Patent. The rejected claims continue to be subject to re-examination; however, they will remain valid and enforceable until the 40,220 Patent expires on January 16, 2013 unless they are cancelled prior to that date. During the three months ended June 30, 2012, there were no material developments relating to the inter-partes proceeding.

In response (in part) to the inter-partes reexamination proceeding, on June 17, 2011, we filed a separate ex-parte reexamination request with the USPTO with respect to other claims described in the 40,220 Patent. As part of this request, we requested amendments to certain claims and also requested the addition of new claims and the cancellation of certain claims described in the 40,220 Patent. On September 13, 2011, the USPTO issued an order granting an ex-partes reexamination with respect to the 40,220 Patent. On January 4, 2012, the USPTO issued a non-final office action in the ex-parte reexamination proceeding pursuant to which: (i) certain claims described by the 40,220 Patent were subject to reexamination; (ii) certain other claims were cancelled (as we requested); (iii) certain other claims were rejected, and (iv) new claims were added. Following our February 1, 2012 response and an examiner interview, the USPTO issued a Notice of Intent to Issue a Reexam Certificate on March 20, 2012. On May 2, 2012 the USPTO issued an Ex-Parte Reexamination Certificate in the ex-parte reexamination proceeding. On the Certificate, certain amended and added claims were confirmed and other claims were cancelled, as we had requested in our originally filed ex-parte reexamination request. As a result of the issuance of the Ex-Parte Reexamination Certificate, the ex-parte reexamination proceeding is closed. The Third Party Requesters did not have the right to participate in the ex-parte reexamination proceeding.

Incidental Litigation

In addition to legal matters as previously reported in our Annual Report filed on Form 10-K for the year ended March 31, 2012, as filed with the Securities and Exchange Commission on June 20, 2012 (file no. 000-13959), 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 1A. RISK FACTORS

There are no material changes to the risk factors as reported in our annual report on Form 10-K for the fiscal year ended March 31, 2012, as filed with the Securities and Exchange Commission on June 20, 2012 (file no. 000-13959).

ITEM 6. EXHIBITS

Exhibits:

The following exhibits are attached hereto or are incorporated herein by reference as indicated in the table below:

Exhibit Number	Description of Document
3.1	Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K for the period ended March 31, 2011 of LML (File No. 000-13959)).
3.2	Bylaws of LML, as amended (incorporated by reference to Exhibit 3.2 to the Quarterly Report on Form 10-Q for the period ended September 30, 2007 of LML (File No. 000-13959)).
31.1*	Rule 13a-14(a) Certification of Principal Executive Officer.
31.2*	Rule 13a-14(a) Certification of Principal Financial Officer.
32.1*	Section 1350 Certification of Principal Executive Officer and Principal Financial Officer.

*Filed herewith

LML PAYMENT SYSTEMS INC.

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

LML PAYMENT SYSTEMS INC.

/s/ Richard R. Schulz
Richard R. Schulz
Controller and Chief Accounting Officer
(Duly Authorized Officer and Chief Accounting Officer)

August 13, 2012