

# iMerchants Limited

First Quarterly Report 2001-2002

## **CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)**

**GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on the GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.**

**Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board and no assurance is given that there will be a liquid market in the securities traded on GEM.**

**The principal means of information dissemination on GEM is publication on the internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website in order to obtain up-to-date information on GEM-listed issuers.**

*This document, for which the directors of iMerchants Limited collectively and individually accept responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange for the purpose of giving information with regard to iMerchants Limited. The directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:- (1) the information contained in this document is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this document misleading; and (3) all opinions expressed in this document have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*

## CHAIRMAN'S STATEMENT

The global economic slowdown is influencing the market for information technology ("IT") applications and services in Asia. However, this is a natural part of any economic cycle and the directors believe that the use of IT by businesses to enhance efficiency, offer new services, create ways of serving customers better and manage their businesses with greater access to data will be a far more enduring trend than any short term economic instability. We are extremely confident that the demand for IT solutions and services will rebound and we are using this difficult time as an opportunity to continue to strengthen iMerchants' position as a leading application software solutions company in Asia by:

- aggressively developing application software solutions, to seek to allow the Company to earn higher margins through license fee income; and
- targeting much of iMerchants' business development effort on the banking and financial services industry, with the expectation that companies in this industry will continue to spend aggressively on technology.

We believe that a number of characteristics define those technology solution firms that will be the leaders in Asia. It will be essential for these firms to have a strong local implementation and support capability, they will have to offer solutions with rich features to enable rapid, cost effective implementation and they will have to possess knowledge of the industries they are serving and the processes their solutions support.

During the quarter ended 30th June, 2001, iMerchants took the opportunity to grow stronger by enhancing these qualities.

- *Competitive solutions:* Over the past several quarters, iMerchants has been shifting its focus from custom development projects to delivering solutions based on a set of application software products. The Company has taken many of the technology components it has proven in projects implemented over the past five years and transformed these into products. This shift has required iMerchants to commit a significant amount of management attention and concentrate many of its team members on product development activities. During the first quarter, a substantial effort was spent on developing and enhancing iMerchants' solutions for online retail banking, online corporate banking, and online bill publishing & interactive customer care and the Collaborative Document Exchange, iMerchants' workflow, collaboration and imaging solution. iMerchants' expects that this effort will repay itself by allowing the Company to earn license fee income for its software products.

- *Industry & process knowledge:* iMerchants is increasingly targeting the banking and financial services industry. The Company has been delivering solutions to this industry since 1996 and in recent quarters has focused more of its business development and product development efforts on this industry. As such, we strongly believe that iMerchants is one of the leading online banking solution providers in Hong Kong. The Company's online retail banking software is used by more banks than virtually any other vendor in the local market. Furthermore, the Company's offering of Internet retail banking, Internet corporate banking, credit card and wealth management solutions position it very strongly.

One of iMerchants' most notable recent successes is the official launch of the NET Alliance banking service bureau in July 2001. This is a partnership between iMerchants and four local banks that enables the sharing of application software amongst the banks using the service and, in so doing, enables each bank to gain access to superior solutions at a lower cost than they would have had to pay on their own. The first application to go live is online retail banking and NET Alliance is planning to launch additional applications in the future including online stock trading and online corporate banking. The directors expect that bureau services for the banking and financial services industry like NET Alliance will take off in the future, as they have begun to in Europe and the United States.





- *Strong local implementation & support capability:* iMerchants was one of the first companies to focus on Internet technologies in Hong Kong and in Asia. The Company continues to have tremendous strength in developing and implementing applications making use of technologies such as Java, ASP and Visual Basic and can provide effective support services to its clients.

With our solid team, excellent application software products and sound foundation of industry knowledge, I am confident that we will see brighter days ahead.


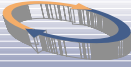

## BUSINESS OUTLOOK

iMerchants has developed a rich suite of application software solutions to enable both financial and non-financial enterprises to broaden their distribution channels, enhance customer service and improve process efficiency.

### Financial Service Industry Solutions

 Retail Financial Services	 Credit Card	 Wealth Management	 Corporate Financial Services
<ul style="list-style-type: none"><li>▶ Online Retail Banking</li><li>▶ PDA Banking</li><li>▶ CDE – Consumer Loan Workflow Application</li><li>▶ billcentrix™ – Bill Management</li></ul>	<ul style="list-style-type: none"><li>▶ Credit Card Statement Publishing &amp; Interactive Customer Care</li><li>▶ CDE – Credit Card Workflow Application</li></ul>	<ul style="list-style-type: none"><li>▶ Mutual Fund Processing</li></ul>	<ul style="list-style-type: none"><li>▶ Online Corporate Banking</li><li>▶ CDE – Investment Banking Application</li></ul>
<ul style="list-style-type: none"><li>▶ Multibank Service Bureau Platform</li><li>▶ CDE – Secure Document Transfer</li></ul>			

### Corporate Solutions

 Online Sales	 Online Marketplace	 Online Bill Publishing & Interactive Customer Care
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iMerchants continues to enhance its existing set of products and is also developing a number of new solutions, including:

- *Mutual fund processing:* A growing number of banks are offering consumers wealth management services including the marketing of mutual funds. iMerchants is developing a system to support the operation of banks' mutual fund sales efforts by supporting order entry, client portfolio administration and back end settlement and reconciliation processes.

- *PDA banking*: The growing adoption of personal digital assistants (PDAs), or hand-held computers provides an opportunity for banks to enhance customer convenience by offering another electronic distribution channel. iMerchants is developing a solution to enable banks to provide banking services over this portable device, so that the customer has the choice of connecting to the bank using a wireless connection or by synchronising the information on the PDA with the bank via a personal computer.
- *Collaborative Document Exchange (CDE) applications*: CDE is iMerchants' workflow, imaging and collaboration platform. CDE provides a highly secure, shared workspace and, by incorporating workflow and imaging components, enables process automation and increased efficiency. The Company used this platform to implement a PKI-enabled secure document transfer system with JETCO, a consortium of more than 50 banks in Hong Kong, southern China and Macau, to enable the secure transmission of files within the JETCO consortium. The flexibility of the platform means that it can support multiple industry specific applications and iMerchants has been developing a number of such applications including: a credit card application processing solution, a loan application processing solution, and an IPO management solution for investment banks.

In July 2001, iMerchants' became an IBM Authorised Business Partner. This gives the Company an opportunity to resell IBM hardware bundled with the solutions it delivers to clients and can be expected to be a source of additional revenue and profit for the Company in the future. Furthermore, IBM's penetration in the banking and financial services industry is expected to help the Company in its business development efforts.

International expansion continues to be very much a part of iMerchants' roadmap. However, in this market environment we continue to be cautious about the approach we take to global growth. Rather than developing a network of our own offices around Asia, we have been very successful at building relationships with global technology companies such as IBM and Intel, whose own global networks we expect will help us as we expand. In addition, we have been working to build deeper relationships with well-connected local enterprises to aid our penetration of markets in Greater China and South East Asia.

## FINANCIAL RESULTS

iMerchants achieved revenue growth of 7% in the quarter ended 30th June, 2001, when compared to the same period last year. Although the current market environment makes revenue growth challenging, iMerchants is actively focusing on building business relationships with existing and potential clients - efforts that can be expected to pay off in the future.

Gross profit fell significantly in the quarter ended 30th June, 2001, when compared to the same period last year. This was caused in part by the Company working to penetrate more deeply into a number of accounts by using aggressive pricing and hardware sales. iMerchants' expectation is that accepting lower margins from these accounts today will pave the way for higher margin sales in the future. In addition, with the Company's drive to generate license fee income from its developed products, it is aiming to increase its gross profit margins on future services.

The Company's administrative expenses totalled approximately HK\$10.6 million in the quarter ended 30th June, 2001, an increase of 16% over the same period in the previous year. This increase is largely resulted from an increase in the Company's depreciation and amortisation expenses, as it begins to amortize its investment in JETCO Online and other technology platforms it implemented.

iMerchants is committed to using the current economic downturn as an opportunity to strengthen its capabilities and business. The Company continues to be in a healthy financial position with net current assets plus an investment in long term securities totalling approximately HK\$300 million without bank borrowings.

## RESULTS

The board of Directors (the “Board”) of the Company presents the unaudited consolidated results of the Company and its subsidiaries (the “Group”) for the three months ended 30th June, 2001 together with the comparative unaudited figures for the corresponding period in 2000 as follows:

		<b>Three months ended 30th June</b>	
	<i>Notes</i>	<b>2001</b> <i>HK\$'000</i>	<b>2000</b> <i>HK\$'000</i>
Turnover	2	8,605	8,025
Direct costs		(8,190)	(3,760)
Gross profit		415	4,265
Other revenue	3	3,548	5,586
Administrative expenses		(10,571)	(9,104)
(Loss) profit from operations		(6,608)	747
Finance costs		—	(1)
Share of results of associates		(1,778)	—
Share of results of a jointly controlled entity		—	—
(Loss) profit for the period		(8,386)	746
(Loss) earnings per share - basic	5	(0.720) cent	0.064 cent



*Notes:*

**1. Basis of preparation of the financial statements**

The Company was incorporated in Hong Kong with limited liability on 25th October, 1999 under the Companies Ordinance. Its ultimate holding company is Galaface Limited, a company incorporated in the British Virgin Islands. The Company is an investment holding company. The principal activities of its subsidiaries are the provision of internet-based services.

Pursuant to a series of group reorganization steps (the "Group Reorganization") to rationalize the Group structure in preparation for the listing of the Company's shares on the GEM of the Stock Exchange, the Company became the holding company of the Group on 10th March, 2000.

The Group Reorganization principally involved the exchange of fully-paid shares of the Company with the entire issued shares of iMerchants Asia Limited (the "Share Exchange").

A strategic investor, Pacific Century CyberWorks Limited ("PCCW") has, through its indirect wholly-owned subsidiary Network Initiatives Limited, invested into the Group prior to the Share Exchange.

The shares of the Company were listed on the GEM of the Stock Exchange on 31st March, 2000.

The Group resulting from the Group Reorganization is regarded as a continuing entity. Accordingly, these financial statements of the Group have been prepared on the merger accounting basis as if the Company had always been the holding company of the Group.

In addition, the Group acquired a wholly-owned subsidiary in May 2000 from its immediate holding company. The acquisition of this subsidiary had been accounted for using the acquisition accounting basis.

**2. Turnover**

Turnover represents revenue generated from contracts for consultancy and software development, including the sale of the related equipment and the amounts received and receivable for other related services rendered.

**3. Other revenue**

Other revenue for the period comprised, among others, interest income of approximately HK\$3,309,000 (2000: HK\$5,258,000).

#### 4. **Taxation**

No provision for Hong Kong Profits Tax has been made as the Group incurred tax losses for the period.

#### 5. **(Loss) earnings per share**

The calculation of the loss per share for the three months ended 30th June, 2001 is based on the loss of the Group for the period of approximately HK\$8,386,000 (2000: profit of approximately HK\$746,000) and on the weighted average number of ordinary shares for the period of 1,164,329,978 (2000: 1,165,476,000).

No diluted loss per share for the period has been presented as the exercise of the Company's outstanding share options would result in a decrease in loss per share.

No diluted earnings per share has been presented for the corresponding period in 2000 as the exercise price of the Company's outstanding share options was higher than the average market price for that period.

#### 6. **Dividend**

The Directors do not recommend the payment of an interim dividend for the three months ended 30th June, 2001 (2000: Nil).

#### 7. **Movements of reserves**

	Share premium HK\$'000	Merger reserve HK\$'000	Capital redemption reserve HK\$'000	Goodwill HK\$'000	Accumulated losses HK\$'000	Total HK\$'000
At 1st April, 2001	207,130	46,715	—	(3,016)	(27,360)	223,469
Reserve arising on repurchase of own shares	—	—	128	—	(258)	(130)
Loss for the period	—	—	—	—	(8,386)	(8,386)
At 30th June, 2001	<u>207,130</u>	<u>46,715</u>	<u>128</u>	<u>(3,016)</u>	<u>(36,004)</u>	<u>214,953</u>

## PURCHASE, SALE OR REDEMPTION OF SHARES

During the period, the Company repurchased on the Stock Exchange a total of 1,284,000 ordinary shares of HK\$0.10 each in the share capital of the Company at an aggregate price of HK\$256,800.00 and the details are as follows:

<b>Date</b>	<b>Repurchased Price</b> <i>HK\$</i>	<b>Number of Shares Repurchased</b>	<b>Aggregate Price Paid</b> <i>HK\$</i>
10th April, 2001	0.20	284,000	56,800.00
11th April, 2001	0.20	1,000,000	200,000.00
		<u>1,284,000</u>	<u>256,800.00</u>

The Directors of the Company considered that the above repurchases were made with a view to enhancing the net asset per share of the Company. These shares were cancelled upon repurchase and the issued share capital of the Company was reduced correspondingly.

Save as disclosed above, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the three months ended 30th June, 2001.

## COMPETING INTERESTS

During the period under review, none of the directors or the management shareholders (as defined in the GEM Listing Rules) of the Company had an interest in a business that competed with the Group or might compete with the business of the Group.

## DIRECTORS' INTERESTS IN SECURITIES

At 30th June, 2001, the interests of the directors of the Company and their associates in the securities of the Company as recorded in the register maintained by the Company pursuant to Section 29 of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance") were as follows:

Name of director	Number of ordinary shares held as		Number of shares entitled under the share option schemes held as
	personal interests	corporate interests	personal interests
Mr Leroy Kung Lin Yuen ("Mr Kung")	—	720,745,000 (Note i)	—
Mr Matthew P Johnston ("Mr Johnston")	100,000	—	23,340,000 (Note ii)

### Notes:

- (i) The registered shareholder of 720,745,000 shares is iMerchants Group Limited ("iMerchants Group"). iMerchants Group is wholly-owned by Asian Gold Associates Limited ("Asian Gold"), in which 76% of the issued share capital of Asian Gold is owned by Galaface Limited ("Galaface"). Mr Kung is deemed to have interests in the 720,745,000 shares owned by iMerchants Group under the SDI Ordinance as he owns the entire interest in Galaface and is entitled to exercise more than one-third of the voting power at general meetings of both Asian Gold and Galaface.
- (ii) Among the balance, 11,670,000 share options were granted on 15th March, 2000 under a pre-IPO share option plan, which was approved by the written resolution of the shareholders of the Company dated 15th March, 2000. These share options entitle Mr Johnston to subscribe for 11,670,000 shares of HK\$0.10 each in the Company at HK\$1.48 each in various stages from 31st March, 2001 to 14th March, 2010.

The remaining 11,670,000 share options were granted on 23rd August, 2000 under a share option scheme, which was approved by the written resolution of the shareholders of the Company dated 15th March, 2000. These share options entitle Mr Johnston to subscribe for 11,670,000 shares of HK\$0.10 each in the Company at HK\$0.53 each during the various periods from 31st March, 2001 to 23rd August, 2010.

Save as disclosed above, at 30th June, 2001, none of the directors or any of their associates had any interests in any securities of the Company or any of its associated corporations as defined in the SDI Ordinance.

## **OUTSTANDING SHARE OPTIONS**

Pursuant to the Pre-IPO Share Option Plan and Share Option Scheme, the principle terms of which were set out in the Prospectus, there were 41,200,000 and 45,810,000 share options, respectively, granted to and held by the optionees (which include the options granted to a director of the Company, as disclosed above) as at 30th June, 2001. Details of which are as follows:

	<b>No. of share options outstanding at 30th June, 2001</b>	<b>Exercise price per Share</b>	<b>Exercise period</b>
Pre-IPO Share Option Plan (Note 1)	41,200,000	HK\$1.48	31st March, 2001 to 14th March, 2010
Share Option Scheme (Note 2)	45,810,000	HK\$0.53	31st March, 2001 to 23rd August, 2010

*Notes:*

- 1 An aggregate of 46,500,000 options were granted to the optionees on 15th March, 2000 under the Pre-IPO Share Option Plan. Up to 30th June, 2001, 5,300,000 share options have lapsed. Options pursuant to the Pre-IPO Share Option Plan may be exercised in accordance with the terms of the relevant scheme as to:
  - (i) one quarter of the options (rounded down to the nearest board lot) will be exercisable from 1st April, 2001 ("First Exercise Date");
  - (ii) an additional one eighth of the options (rounded down to the nearest board lot) will be exercisable after the expiry of each successive six month period from the First Exercise Date; and
  - (iii) the balance of the options exercisable after the expiry of a period of 48 months from 1st April, 2001.

As of 30th June, 2001, no options under the Pre-IPO Share Option Plan have been exercised.

- 2 An aggregate of 47,240,000 options were granted to the optionees on 23rd August, 2000 under the Share Option Scheme. Up to 30th June, 2001, 1,430,000 Share options have lapsed. . Options pursuant to the Share Option Scheme may be exercised in accordance with the terms of the relevant scheme which are the same as those of the Pre-IPO Share Option Plan set out in paragraph 1 above.

As of 30th June, 2001, no options under the Share Option Scheme have been exercised.

Save as disclosed above, during the three months ended 30th June, 2001, none of the directors and employees of the Company or its subsidiaries was granted options to subscribe for shares in the Company.

## **DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES**

Other than the share option schemes as described in the section headed "OUTSTANDING SHARE OPTIONS" above, at no time during the period was the Company, any of its holding companies, fellow subsidiaries or subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate and none of the directors, or their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such rights.

## **SUBSTANTIAL SHAREHOLDERS**

At 30th June, 2001, other than the interests disclosed in the section headed "Directors' Interests in Securities" above, the Company has not been notified of any other interests at 30th June, 2001 representing 10% or more of the issued share capital of the Company.

## **SPONSOR'S INTERESTS**

As updated and notified by the Company's Sponsor BNP Paribas Peregrine Capital Limited (the "Sponsor"), at 30th June, 2001, neither the Sponsor nor its directors or employees or associates (as referred to in Note 3 to rule 6.35 of the GEM Listing Rules) had any interests in the securities of the Company or any member of the Group or any rights to subscribe for or to nominate persons to subscribe for the securities of the Company or any member of the Group.

Pursuant to the agreement dated 30th March, 2000 entered into between the Company and the Sponsor, the Sponsor will receive usual sponsorship fees for acting as the Company's retained sponsor for the period from 31st March, 2000 to 31st March, 2002.

## **OTHER DIRECTORS' INTERESTS**

Mr Alex Ko Po Ming, an independent non-executive director, is the chairman of BNP Paribas Peregrine Capital Limited (formerly known as BNP Prime Peregrine Capital Limited). Mr Alex Ko Po Ming is interested in BNP Paribas Peregrine Capital Limited, which entered into a sponsorship agreement with the Company on 30th March, 2000 pursuant to which BNP Paribas Peregrine Capital Limited would act as sponsor to the Company, and will receive the usual sponsorship fees in connection therewith, up to 31st March, 2002.

Mr Ronny Chow Fan Chim, an independent non-executive director, is a partner of Deacons (formerly known as Deacons Graham & James), legal advisers to the Company. Deacons will receive the usual professional fees in connection with the legal services it provides to the Company from time to time.

## **AUDIT COMMITTEE**

The Company's audit committee was formed on 15th March, 2000, comprising all the independent non-executive directors, namely, Dr Alice Piera Lam Lee Kiu Yue and Messrs Alex Ko Po Ming and Ronny Chow Fan Chim. The terms of reference of the audit committee have been established with regard to "A Guide for the Formation of an Audit Committee" issued by the Hong Kong Society of Accountants in December 1997. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control procedures of the Group.

By order of the Board  
**Leroy Kung Lin Yuen**  
*Chairman*

Hong Kong, 13th August, 2001