

# iMerchants Limited

First Quarterly Report 2002-2003

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## Chairman's Statement

I am pleased to announce the results of iMerchants Limited for the three months ended 30 June 2002.

With this quarter, iMerchants has entered its third year as a listed company in Hong Kong. The past two years have been both eventful and challenging for iMerchants and for the Hong Kong Information Technology ("IT") industry as a whole. We enjoyed the industry boom of the late 1990's and have felt the pain of the following global market downfall. Today clients are exceptionally hesitant and careful with their IT investments and those surviving IT companies are subject to intense competition and heavy price pressures.

The challenge for an IT company like iMerchants is to weather the current storm and to take this opportunity to build a stronger organization and to enhance its solution portfolio so that the company will be well positioned for the future.

## Business Review

iMerchants has taken a deliberate and focused tact to address the continued market pessimism and to build its strength for the future. Building on our earlier initiatives, highlights from the past quarter include:

- *iMerchants' Wealth Management Suite*: This new addition to our solution portfolio was recently soft-launched with a series of private previews offered to individual banks and insurance companies. A growing number of banks, insurers and stockbrokers are offering consumers wealth management services. This solution provides wealth management tools including support for a range of financial products such as mutual funds and bonds.

- *Focused promotional activities:*
  - Recent global events have triggered an intense interest in data security technologies. iMerchants' Electronic Transaction Management Solution very effectively positions the Company as an expert in this area. As such iMerchants has conducted a number of educational sessions on data security, with Hongkong Post for Hong Kong's banking sector, and with Hongkong Post and the Information Technology Services Department of the Hong Kong Government for Hong Kong's civil servants.
  - Addressing the rapid evolution of mobile technologies in Hong Kong, iMerchants collaborated with IBM to present its Secure Wireless Banking Solution to an audience of senior executives from Hong Kong's financial services industry.
- *Commitment to quality:* In April 2002, iMerchants' core business processes including prospecting and engagement through to development, implementation and client support, were certified as compliant with the ISO 9001:2000 quality standard. This past quarter iMerchants initiated new continuous improvement procedures that will enable the Company to further enhance its sales and service delivery methodology on an ongoing basis.

## Business Outlook

iMerchants offers a set of industry specific solutions for the financial services sector in combination with custom development and system integration services for both financial services and government sectors. We believe that the use of IT by government and by financial services institutions will be an enduring trend. Be it to enhance efficiency, offer new services, create ways of serving customers better or to manage their business through greater access to information, the value proposition that IT brings to organizations is truly enduring.

We also believe that our software solution portfolio holds the potential to carry us forward in meeting the needs of the financial services and government sectors. This future does not come without tangible commitment and iMerchants has invested and continues to invest in enhancing and evolving its solutions to address the evolving market trends.

iMerchants' new Wealth Management Suite addresses the growing trend in the financial services community to provide new wealth management services to the mass affluent. Equally effective for banks, insurance companies and brokerages this suite provides staff with instant access to customer portfolios, interactive portfolio assessment and other sales support tools plus on demand updates for investment products. Specifically the suite equips frontline staff to manage their customer accounts more efficiently and effectively; and to deliver the personal service that their high-value customers want in a cost effective and scalable manner. This suite leverages the knowledge and expertise gained by iMerchants through the earlier development of iMerchants' Mutual Fund Solution.

Given the current trend towards improvements in data security, iMerchants is well positioned to meet the needs of the Hong Kong market both in the financial services and government sectors. iMerchants' security expertise is encapsulated in its Electronic Transaction Management ("ETM") solution which enables institutions to deploy Public Key Infrastructure ("PKI") by providing the components

necessary for certificate management, certificate validation, transaction proof management ensuring legal-grade status of digital transactions, and registration authority operations, should they be required. This solution was recently implemented by a leading bank in Hong Kong to PKI-enable their online corporate banking service.

Additionally, iMerchants has incorporated its security expertise into its Secure File Exchange 2 Solution. Deployed for a large banking consortium, this solution uses PKI to enable highly secure, efficient and cost effective transfer of data via Internet technology. iMerchants' partnership with Diversinet Corporation last year also allows the Company to carry its security expertise over into the mobile service realm offering clients the opportunity to extend the reach of their PKI-enabled applications.

There is ample room for optimism for the future. Despite the poor economic environment, I am excited about the progress that iMerchants has made over the past years and look forward to seeing these exciting initiatives yielding benefits in the future.

## Financial Review

This past quarter iMerchants financial results continue to reflect the effects of extended sales cycles and decreased client budgets.

In these difficult economic times, customers have cut back on discretionary expenditure and, consequently, reduced their budgets for information technology-related expenditure, meaning that many projects have been scaled back or even aborted. In addition, our competitors fought aggressively on price, pushing down revenues and profits, leading some projects to generate negative margins. This has been a continuous trend in the market since early last year, which has become more pronounced in recent months and has had a negative effect on iMerchants' financial results. For the three months ended 30 June 2002, the Company achieved a turnover of approximately HK\$1,566,000 (2001: HK\$8,605,000) and generated a loss for the period of approximately HK\$10,420,000 (2001: loss of HK\$8,386,000).

Administrative expenses were 16.6% higher for the three months ended 30 June 2002 when compared to the corresponding period last year. In part, this was due to the start of operations of our wholly-owned subsidiary in Beijing in April 2002 and thus set-up costs and additional recurring office expenses and staff costs were incurred. Moreover, the directors of the Company took a conservative approach in the last financial year to recognize the impairment loss on the IT platforms developed by the Company and have retained this view. As a result, the direct labour costs were not capitalized as intangible assets but rather recorded as salaries expenses for the period which increased the administrative expenses. The Company continues its effort to control spending.

The Company continues to be in a strong financial position, with net cash balance, time deposits plus investments in marketable debt securities over HK\$232 million without any 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 30 June 2002 together with the comparative unaudited figures for the corresponding period in 2001 as follows:

		Three months ended	
		30 June	
		2002	2001
	Notes	HK\$'000	HK\$'000
Turnover	2	1,566	8,605
Cost of sales and direct costs		<u>(1,707)</u>	<u>(8,190)</u>
Gross (loss) profit		(141)	415
Other revenue	3	2,052	3,548
Administrative expenses		<u>(12,331)</u>	<u>(10,571)</u>
Loss from operations		(10,420)	(6,608)
Share of results of associates		<u>—</u>	<u>(1,778)</u>
Loss before taxation		(10,420)	(8,386)
Taxation	4	<u>—</u>	<u>—</u>
Loss attributable to shareholders		<u>(10,420)</u>	<u>(8,386)</u>
Loss per share — basic	5	<u>(0.897) cent</u>	<u>(0.720) cent</u>

Notes:

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

The financial statements have been prepared under the historical cost convention and in accordance with accounting principles generally accepted in Hong Kong.



**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, and sales of goods by the Group to customers during the period.

**3. Other revenue**

Other revenue for the period comprised, among others, interest income of approximately HK\$2,052,000 (2001: HK\$3,309,000).

**4. Taxation**

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

**5. Loss per share**

The calculation of the loss per share for the three months ended 30 June 2002 is based on the loss of the Group for the period of approximately HK\$10,420,000 (2001: HK\$8,386,000) and on the weighted average number of ordinary shares for the period of 1,161,382,000 (2001: 1,164,329,978).

No diluted loss per share has been presented because the exercise price of the Company's outstanding share options were higher than the average market price of the Company's shares for both periods.

**6. Dividend**

The Directors do not recommend the payment of an interim dividend for the three months ended 30 June 2002 (2001: Nil).

## 7. Movements of reserves

	Share premium HK\$'000	Goodwill HK\$'000	Negative goodwill HK\$'000	Capital redemption reserve HK\$'000	Merger reserve HK\$'000	Accumulated losses HK\$'000	Total HK\$'000
At 1 April 2001	207,130	(4,900)	1,884	—	46,715	(27,360)	223,469
Premium arising on share repurchases	—	—	—	—	(130)	—	(130)
Transfer	—	—	—	128	(128)	—	—
Loss for the period	—	—	—	—	—	(8,386)	(8,386)
At 30 June 2001	<u>207,130</u>	<u>(4,900)</u>	<u>1,884</u>	<u>128</u>	<u>46,457</u>	<u>(35,746)</u>	<u>214,953</u>

	Share premium HK\$'000	Negative goodwill HK\$'000	Capital redemption reserve HK\$'000	Merger reserve HK\$'000	Accumulated losses HK\$'000	Total HK\$'000
At 1 April 2002	207,130	1,884	409	45,918	(107,032)	148,309
Loss for the period	—	—	—	—	(10,420)	(10,420)
At 30 June 2002	<u>207,130</u>	<u>1,884</u>	<u>409</u>	<u>45,918</u>	<u>(117,452)</u>	<u>137,889</u>

## Purchase, Sale or Redemption of Shares

During the three months ended 30 June 2002, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

## 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 30 June 2002, 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")	—	744,219,000 <i>(Note i)</i>	—
Mr Matthew P Johnston ("Mr Johnston")	100,000	—	23,340,000 <i>(Note ii)</i>

### Notes:

- (i) The registered shareholder of 744,219,000 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 744,219,000 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 15 March 2000 under a pre-IPO share option plan, which was approved by the written resolution of the shareholders of the Company dated 15 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 31 March 2001 to 14 March 2010.

The remaining 11,670,000 share options were granted on 23 August 2000 under a share option scheme, which was approved by the written resolution of the shareholders of the Company dated 15 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 31 March 2001 to 23 August 2010.

Save as disclosed above, at 30 June 2002, 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.

## Directors' Rights to Acquire Shares or Debentures

Other than the share option schemes as described in the section headed "DIRECTORS' INTERESTS IN SECURITIES" 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 30 June 2002, 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 30 June 2002 representing 10% or more of the issued share capital of the Company.

## Other Director's Interests

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 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 15 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, 9 August 2002