

iMerchants Limited  
Third Quarterly Report 2002-2003

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*This report, 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 report 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 report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*

## CHAIRMAN'S STATEMENT

This year continues to be an exciting year of change for iMerchants. Over the past three months, the Company has continued to invest and build on the strategic initiatives begun in the previous two quarters. Today's market presents us with significant opportunities. Although the market continues to be somewhat slow, we are excited by our new direction and believe it holds excellent potential for the Company in the future.

## BUSINESS DIRECTION

Building on the business assessment and restructuring effort initiated in the second quarter, iMerchants continues to work on strengthening its financial and market positions for the future.

To date, we have made substantial progress in developing our Wealth Management product offering and I am pleased to report our first major contract in the Wealth Management area with Hong Kong-based Wing Lung Bank. To support the Bank's wealth management operations, specifically in the area of Mutual Fund sales, we will deploy four components from our WealthSuite™ product line: the Financial Planner, Portfolio Manager, Research Centre and Mutual Funds, an order processing system. The solution will be tailored to address the Bank's unique requirements and integrated with a data service provider for real-time fund information and with several prominent fund houses for enhanced order processing efficiency.

In the past quarter, we have also made preparations for a shift in the way we present our Wealth Management product offering to the market with plans to transfer the Wealth Management product line to iMerchants' wholly-owned subsidiary, Asia Financial Network ("AFN"). We believe AFN's position as a provider of online financial services is very fitting for the Wealth Management line, and that this transition will serve the Company well in the long run as we expand our marketing and sales network beyond the local Hong Kong market to areas where the iMerchants' name is less well known. The transition will be made official in the next quarter and will at that time be reflected in our product marketing and sales materials, and will be supported by a series of marketing activities to help build awareness in the market of the change in branding.

Another important change is that of the name and business nature of iMerchants' Professional Services business line. The Professional Services business line has developed a wide range of bespoke applications over the years. Recognizing the changing market environment that now presents a highly price-competitive situation, iMerchants will shift its focus to providing Client Support Services including maintenance and selected IT operations, which offer both higher margin and more stable and predictable revenue streams.

In April 2002, iMerchants' core business processes were certified as compliant with the ISO 9001:2000 quality standard, and in December 2002 the Company successfully completed its first ISO review. The Company has also initiated continuous improvement procedures to further enhance its sale and service delivery methodology on an ongoing basis. We believe that these efforts are already producing very positive results for both the Company and our clients, and have improved the Company's ability to compete.

## PROSPECTS FOR NEW BUSINESS

iMerchants' target market, the financial service sector, continues to be under great pressure. With recent decreases in interest rates, financial institutions are looking to other means of accessing revenues. Many are turning to wealth management services to capture the related service fee income and, as the services become more and more popular, to meet customer demand and to remain competitive.

iMerchants' product line enables financial services institutions to enhance and streamline their wealth management services and order processing operations. As a product group it is highly flexible, enabling institutions to mix and match within the product group to create the solution that best fits their needs, providing value to a wide range of potential clients.

We believe that Wealth Management is an area of opportunity for us. We have and continue to make a substantial investment in developing our WealthSuite™ product line. The Company has a long-term product roadmap which includes building out the product both organically and through integrating with other leading solution and service providers to create the best solution for the Hong Kong market and subsequently that of the Mainland. The Company is currently talking to a number of potential partners in this regard and expects to further these relationships to enhance the marketability of our WealthSuite™ product line in the coming quarter. Also in the coming quarter, we will be transferring the Wealth Management business line to AFN and will initiate a series of corresponding marketing and press activities to build awareness in the market. From both technical and business perspectives, the Company is taking a highly focused approach in building up this exciting new area.

In the area of Client Support Services, the Company continues to work for a number of strategic clients and is currently exploring other related opportunities.

## FINANCIAL REVIEW

The Company's financial results for the past quarter continue to show the effects of a difficult market as well as the Company's recent restructuring and strategic initiatives. Largely due to a substantial reduction in related hardware sales in the past nine months, the Company recorded a decrease in turnover to HK\$6,096,000 from HK\$16,445,000 for the corresponding nine months in 2001. Although this decrease appears dramatic, its impact on the bottom line has been offset by a shift to higher margin sales as well as improvements in service delivery efficiency, resulting in an actual increase in gross profit for the same period from HK\$247,000 to HK\$1,219,000. Quarter on quarter, the Company has recorded an increase in gross margin percentage for the past three quarters.

For the three months ended 31 December 2002, the Company's turnover was approximately HK\$1,620,000 representing a 44% decrease from the previous quarter. This decrease was expected and reflects the Company's shift in focus from system integration and custom development to development of the Wealth Management product line. This past quarter has been one of investment for the wealth management product suite with the view that substantial revenue from it will be forthcoming.

The nine months ended 31 December 2002 show an increase in administrative expenses to HK\$38,812,000 from HK\$30,947,000 for the same period in the previous year. This is largely due to the adoption, in the current year, of a more conservative approach for recognition of product development related salaries and the compensation costs related to restructuring. This quarter, iMerchants realized a 23% decrease in salary expense as a result of the Company's restructuring effort at the end of September, however, the corresponding financial benefit was largely offset by the one-off expense incurred at the end of December related to an additional restructuring. Over the previous months, staff headcount has been reduced both through the September and December restructuring efforts and through attrition. The related financial benefits will be reflected in the coming quarters. The Company is working diligently to control spending and to improve efficiency.

iMerchants continues to be in a strong financial position, with current assets plus investments in marketable securities and time deposits totalling approximately HK\$225 million and no bank borrowings as at 31 December 2002.

## 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 and nine months ended 31 December 2002, together with the comparative unaudited figures for the corresponding periods in 2001, as follows:

|  |       | Three months ended<br>31 December |              | Nine months ended<br>31 December |              |
|--|-------|-----------------------------------|--------------|----------------------------------|--------------|
|  |       | 2002                              | 2001         | 2002                             | 2001         |
|  | Notes | HK\$'000                          | HK\$'000     | HK\$'000                         | HK\$'000     |
| Turnover   | 2     | 1,620                             | 3,168        | 6,096                            | 16,445       |
| Cost of sales and direct costs                             |       | (1,012)                           | (3,151)      | (4,877)                          | (16,198)     |
| Gross profit   |       | 608                               | 17           | 1,219                            | 247          |
| Other revenue  | 3     | 2,467                             | 1,673        | 6,488                            | 7,999        |
| Administrative expenses                                    |       | (11,609)                          | (9,673)      | (38,812)                         | (30,947)     |
| Loss from operations                                       | 4     | (8,534)                           | (7,983)      | (31,105)                         | (22,701)     |
| Finance costs  |       | -                                 | (1)          | -                                | (8)          |
| Provision for investment in a<br>jointly controlled entity |       | -                                 | (3,695)      | -                                | (3,695)      |
| Share of results of associates                             |       | -                                 | (111)        | -                                | (2,036)      |
| Loss before taxation                                       |       | (8,534)                           | (11,790)     | (31,105)                         | (28,440)     |
| Taxation   | 5     | -                                 | -            | -                                | -            |
| Loss attributable<br>to shareholders                       |       | (8,534)                           | (11,790)     | (31,105)                         | (28,440)     |
| Loss per share - basic                                     | 6     | (0.735) cent                      | (1.015) cent | (2.678) cent                     | (2.445) cent |

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\$6,274,000 (2001: HK\$7,461,000).

4. Loss from operations

Loss from operations is arrived at after charging:

|   | <b>Nine months ended</b> |          |
|---|--------------------------|----------|
|   | <b>31 December</b>       |          |
|   | <b>2002</b>              | 2001     |
|   | <b>HK\$'000</b>          | HK\$'000 |
| Depreciation  | <b>4,640</b>             | 4,566    |
| Amortisation of platform development costs                            | –                        | 1,474    |
| Amortisation of premium on acquisition of held-to-maturity securities | <b>714</b>               | 43       |

5. Taxation

No provision for Hong Kong Profits Tax has been made as the Group incurred tax losses for the period (2001: Nil).



6. Loss per share

The calculation of the loss per share for the three months and the nine months ended 31 December 2002 is based on the loss of the Group of approximately HK\$8,534,000 (2001: HK\$11,790,000) and approximately HK\$31,105,000 (2001: HK\$28,440,000), respectively, and on the weighted average number of ordinary shares of 1,161,382,000 (2001: 1,163,264,531).

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

7. Interim dividend

The Directors do not recommend the payment of an interim dividend for the nine months ended 31 December 2002 (2001: Nil).

8. Movements of reserves

|                                      | Share premium<br>HK\$'000 | Goodwill<br>HK\$'000 | Capital                       |                                | Merger reserve<br>HK\$'000 | Accumulated losses<br>HK\$'000 | Total<br>HK\$'000 |
|--------------------------------------|---------------------------|----------------------|-------------------------------|--------------------------------|----------------------------|--------------------------------|-------------------|
|                                      |                           |                      | Negative goodwill<br>HK\$'000 | redemption reserve<br>HK\$'000 |                            |                                |                   |
| At 1 April 2001                      | 207,130                   | (4,900)              | 1,884                         | -                              | 46,715                     | (27,360)                       | 223,469           |
| Premium arising on share repurchases | -                         | -                    | -                             | -                              | (387)                      | -                              | (387)             |
| Transfer                             | -                         | -                    | -                             | 409                            | (409)                      | -                              | -                 |
| Loss for the period                  | -                         | -                    | -                             | -                              | -                          | (28,440)                       | (28,440)          |
| At 31 December 2001                  | <u>207,130</u>            | <u>(4,900)</u>       | <u>1,884</u>                  | <u>409</u>                     | <u>45,919</u>              | <u>(55,800)</u>                | <u>194,642</u>    |

|                     | Share premium<br>HK\$'000 | Goodwill<br>HK\$'000 | Capital                       |                                | Merger reserve<br>HK\$'000 | Accumulated losses<br>HK\$'000 | Total<br>HK\$'000 |
|---------------------|---------------------------|----------------------|-------------------------------|--------------------------------|----------------------------|--------------------------------|-------------------|
|                     |                           |                      | Negative goodwill<br>HK\$'000 | redemption reserve<br>HK\$'000 |                            |                                |                   |
| At 1 April 2002     | 207,130                   | -                    | 1,884                         | 409                            | 45,918                     | (107,032)                      | 148,309           |
| Loss for the period | -                         | -                    | -                             | -                              | -                          | (31,105)                       | (31,105)          |
| At 31 December 2002 | <u>207,130</u>            | <u>-</u>             | <u>1,884</u>                  | <u>409</u>                     | <u>45,918</u>              | <u>(138,137)</u>               | <u>117,204</u>    |

## PURCHASE, SALE OR REDEMPTION OF SHARES

During the nine months ended 31 December 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 31 December 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") | –                                 | 747,523,000<br>(Note i) | –  |
| Mr Edward Un Ding Bong ("Mr Un")   | –                                 | –                       | 10,000,000<br>(Note ii)  |

*Notes:*

- (i) The registered shareholder of 747,523,000 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 747,523,000 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, 2,000,000 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 Un to subscribe for 2,000,000 shares of HK\$0.10 each in the Company at HK\$0.53 each in various stages from 31 March 2001 to 23 August 2010.

The remaining 8,000,000 share options were granted on 27 September 2002 under the 2002 Share Option Scheme, which was approved by the shareholders of the Company in the special general meeting dated 2 August 2002. These share options entitle Mr Un to subscribe for 8,000,000 shares of HK\$0.10 each in the Company at HK\$0.172 each in various stages from 1 September 2003 to 28 August 2012.

Save as disclosed above, at 31 December 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 31 December 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 31 December 2002 representing 10% or more of the issued share capital of the Company.

## OTHER DIRECTORS’ INTERESTS

Mr Ronny Chow Fan Chim, an independent non-executive director, is a partner of Deacons, 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. The audit committee has reviewed the draft of this document and has provided advice and comments thereon.

## BOARD PRACTICES AND PROCEDURES

The Company has complied with Board Practices and Procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules during the nine months ended 31 December 2002.

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

Hong Kong, 14 February 2003