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 December 31, 2009

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®

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

Yukon Territory	**980-20-9289**
(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 February 3, 2010, was 27,116,408.

LML PAYMENT SYSTEMS INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2009

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

PART I. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

LML PAYMENT SYSTEMS INC.

CONSOLIDATED BALANCE SHEETS
(In U.S. Dollars, except as noted below)
(Unaudited)

	December 31, 2009	March 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	**$3,979,487**	$6,138,530
Funds held in trust	**718,093**	-
Funds held for merchants (Note 8)	**4,266,636**	10,746,731
Restricted cash	**175,000**	175,000
Accounts receivable, less allowances of $30,474 and $31,785, respectively	**756,967**	801,087
Corporate taxes receivable	**582,863**	-
Prepaid expenses	**301,257**	295,702
Current portion of future income tax assets	**1,852,894**	838,575
Total current assets	**12,633,197**	18,995,625
Property and equipment, net	**235,978**	227,324
Patents, net	**497,160**	622,730
Restricted cash	**250,048**	125,030
Future income tax assets	**3,370,685**	4,429,578
Other assets	**20,362**	19,020
Goodwill	**17,874,202**	17,874,202
Other intangible assets, net	**4,834,125**	5,205,487
TOTAL ASSETS	**$39,715,757**	$47,498,996
LIABILITIES		
Current Liabilities		
Accounts payable	**$748,215**	$756,845
Accrued liabilities	**765,071**	814,094
Corporate taxes payable	**-**	283,794
Funds due to merchants (Note 8)	**4,266,636**	10,746,731
Obligations under capital lease	**30,043**	170,243
Promissory notes	**-**	2,100,920
Current portion of deferred revenue	**1,312,366**	1,361,046
Total current liabilities	**7,122,331**	16,233,673
Deferred revenue	**2,466,031**	3,330,630
TOTAL LIABILITIES	**9,588,362**	19,564,303
Commitments and Contingencies (Note 11)		
SHAREHOLDERS' EQUITY		
Capital Stock		
Class A, preferred stock, $1.00 CDN par value, 150,000,000 shares authorized, issuable in series, none issued or outstanding	**-**	-
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, 27,116,408 and 27,116,408 issued and outstanding, respectively	**50,039,568**	50,039,568
Contributed surplus	**7,663,735**	6,732,059
Deficit	**(27,680,447)**	(28,751,456)
Accumulated other comprehensive income (loss)	**104,539**	(85,478)
Total shareholders' equity	**30,127,395**	27,934,693
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$39,715,757**	$47,498,996

See accompanying notes to the unaudited consolidated financial statements.

LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
(In U.S. Dollars, except share data)
(Unaudited)

	Three Months Ended December 31		Nine months Ended December 31	
	2009	2008	**2009**	2008
REVENUE	**$4, 742,568**	$3,037,241	**$ 11,229,773**	$9,301,687
COST OF REVENUE (includes stock-based compensation ("s.b.c.") expense of $37,464 for three months ended December 31, 2009 (three months ended December 31, 2008 - $37,464) and $111,579 for nine months ended December 31, 2009 (nine months ended December 31, 2008 - $113,066))	**2,329,810**	1,560,708	**5,670,576**	4,580,407
GROSS PROFIT (excludes amortization and depreciation expense)	**2,412,758**	1,476,533	**5,559,197**	4,721,280
OPERATING EXPENSES				
General and administrative (includes s.b.c. expense of $243,028 for three months ended December 31, 2009 (three months ended December 31, 2008 - $274,297) and $781,386 for nine months ended December 31, 2009 (nine months ended December 31, 2008- $871,255))	**1,059,165**	962,623	**3,083,629**	3,209,063
Sales and marketing (includes s.b.c. expense of $765 for three months ended December 31, 2009 (three months ended December 31, 2008 - $765) and $2,277 for nine months ended December 31, 2009 (nine months ended December 31, 2008 - $2,285))	**103,481**	77,149	**296,084**	237,715
Product development and enhancement (includes s.b.c. expense of $12,233 for three months ended December 31, 2009 (three months ended December 31, 2008 - $12,233) and $36,434 for nine months ended December 31, 2009 (nine months ended December 31, 2008 - $36,567))	**122,759**	58,279	**342,585**	197,589
Amortization and depreciation	**200,346**	197,102	**596,930**	589,654
(Gain) on sale of assets	**-**	-	**(3,830)**	(864)
INCOME BEFORE OTHER INCOME (EXPENSES) AND INCOME TAXES	**927,007**	181,380	**1,243,799**	488,123
Foreign exchange gain	**10,928**	281,682	**135,296**	380,650
Other income (expenses)	**-**	10,833	**(50,641)**	29,808
Interest income	**4,285**	58,750	**20,549**	202,719
Interest expense	**(846)**	(45,269)	**(47,676)**	(204,154)
INCOME BEFORE INCOME TAXES	**941,374**	487,376	**1,301,327**	897,146
Income tax expense (recovery) (Note 10)				
Current	**(324,275)**	206,074	**(323,647)**	597,018
Future	**650,119**	-	**553,965**	-
	325,844	206,074	**230,318**	597,018
NET INCOME	**615,530**	281,302	**1,071,009**	300,128
DEFICIT, beginning of period	**(28,295,977)**	(34,187,796)	**(28,751,456)**	(34,206,622)
DEFICIT, end of period	**$(27,680,447)**	$(33,906,494)	**$(27,680,447)**	$(33,906,494)
EARNINGS PER SHARE, basic and diluted	**$0.02**	$0.01	**$0.04**	$0.01
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	**27,116,408**	27,116,408	**27,116,408**	26,741,795
Diluted	**27,252,792**	27,116,408	**27,150,430**	26,741,795

See accompanying notes to the unaudited consolidated financial statements.

LML PAYMENT SYSTEMS INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In U.S. Dollars)
(Unaudited)

	Three Months Ended December 31		Nine months Ended December 31	
	2009	2008	**2009**	2008
Net income	**$615,530**	$281,302	**$1,071,009**	$300,128
Unrealized foreign exchange gain on translation of self- sustaining operations	**23,174**	782	**190,017**	14,332
Comprehensive income	**$638,704**	$282,084	**$1,261,026**	$314,460

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 December 31		Nine months Ended December 31	
	2009	2008	**2009**	2008
Operating Activities:				
Net income	**$615,530**	$281,302	**$1,071,009**	$300,128
Adjustments to reconcile net income to net cash provided by (used in) operating activities				
Provision for losses on accounts receivable	**-**	-	**5,705**	-
Amortization and depreciation	**200,346**	197,102	**596,930**	589,654
Gain on sale of assets	**-**	-	**(3,830)**	(864)
Stock-based compensation	**293,490**	324,759	**931,676**	1,023,173
Future income taxes	**650,119**	-	**553,965**	-
Foreign exchange (gain) loss	**(52,253)**	(302,231)	**(331,716)**	(298,891)
Changes in non-cash operating working capital				
Funds held in trust	**(718,093)**	-	**(718,093)**	-
Restricted cash	**(100,000)**	-	**(100,000)**	125,000
Accounts receivable	**(145,436)**	1,217	**71,714**	136,826
Corporate taxes receivable	**(432,147)**	-	**(582,863)**	-
Prepaid expenses	**152,228**	(21,094)	**3,202**	(31,127)
Accounts payable and accrued liabilities	**(4,503)**	31,649	**(70,949)**	(801,937)
Corporate taxes payable	**(6,991)**	55,872	**(327,673)**	(517,121)
Deferred revenue	**(377,545)**	(348,875)	**(923,947)**	(1,108,374)
Net cash provided by (used in) operating activities	**74,745**	219,701	**175,130**	(583,533)
Investing Activities:				
Acquisition of property and equipment	**(75,497)**	(16,744)	**(90,017)**	(106,147)
Proceeds from disposal of property and equipment	**-**	-	**3,830**	5,500
Development of patents	**-**	-	**-**	(1,652)
Net cash used in investing activities	**(75,497)**	(16,744)	**(86,187)**	(102,299)
Financing Activities:				
Payments on capital leases	**(39,552)**	(48,939)	**(140,882)**	(142,335)
Payment on promissory notes	**-**	-	**(2,321,460)**	(2,843,974)
Share capital financing costs	**-**	-	**-**	(3,537)
Net cash used in financing activities	**(39,552)**	(48,939)	**(2,462,342)**	(2,989,846)
Effects of foreign exchange rate changes on cash and cash equivalents	**16,457**	(54,565)	**214,356**	(39,236)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(23,847)**	99,453	**(2,159,043)**	(3,714,914)
Cash and cash equivalents, beginning of period	**4,003,334**	5,935,401	**6,138,530**	9,749,768
Cash and cash equivalents, end of period	**$3,979,487**	$6,034,854	**$3,979,487**	$6,034,854
Supplemental disclosure of cash flow information				
Interest paid	**$846**	$4,581	**$47,939**	$411,171
Taxes paid	**-**	$201,476	**$435,138**	$1,173,893
Non-cash investing and financing transactions not included in cash flows:				
Issuance of common shares pursuant to earn-out provision	**-**	-	**-**	$1,971,125

See accompanying notes to the unaudited consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The consolidated balance sheet as of December 31, 2009, the consolidated statements of operations and deficit for the three and nine months ended December 31, 2009 and 2008, the consolidated statements of cash flows for the three and nine months ended December 31, 2009 and 2008 and the consolidated statements of comprehensive income for the three and nine months ended December 31, 2009 and 2008, of LML Payment Systems Inc. and its subsidiaries (collectively, the "Corporation") are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of such financial statements are included herein. Other than those discussed in the notes below, such adjustments consist only of normal recurring items. Interim results are not necessarily indicative of results for a full year. The Corporation's consolidated balance sheet as of March 31, 2009, was derived from audited financial statements. The Corporation's consolidated financial statements and notes are presented in accordance with generally accepted accounting principles in Canada for interim financial information and in accordance with the instructions for Form 10-Q and Article 10 of Regulation S-X, and do not contain certain information included in the Corporation's annual audited consolidated financial statements and notes. Unless otherwise noted, the accounting policies of the Corporation are unchanged from the Corporation's annual audited consolidated financial statements contained in the Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2009. The consolidated financial statements and notes appearing in this report should be read in conjunction with the Corporation's annual audited consolidated financial statements and related notes thereto, together with management's discussion and analysis of financial condition and results of operations, contained in the Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2009, as filed with the Securities and Exchange Commission on June 23, 2009 (file no. 000-13959).

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.

<u>CANADA</u>
Legacy Promotions Inc.
Beanstream Internet Commerce Inc. ("Beanstream")
0858669 B.C. Ltd.

<u>UNITED STATES</u>
LHTW Properties Inc.
LML Corp.
LML Patent Corp.
LML Payment Systems Corp.
Beanstream Internet Commerce Corp.

2. Significant Accounting Policies

All significant accounting policies remain unchanged from the Corporation's audited consolidated financial statements contained in the Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2009 except as noted below:

Revenue Recognition

In addition to recognizing revenue in accordance with the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3400, "Revenue" and with the corresponding U.S. Guidance SAB 104, "Revenue Recognition", the Corporation has adopted the provisions of CICA's Emerging Issues Committee Abstract of Issues Discussed, "Multiple Deliverable Revenue Arrangements" ("EIC 175"), issued on December 24, 2009, regarding revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance.

Within the Intellectual Property Licensing ("IPL") segment, when a subsidiary of the Corporation enters into licensing and settlement agreements with its licensees comprising multiple elements, the significant factors, inputs, assumptions and methods used in determining the total arrangement consideration include reviewing royalty rates from existing licenses, depth of usage, including transaction volumes, by the existing licensees of the IPL segment's intellectual property and estimation of the expected usage by licensees of the IPL segment's intellectual property. Total arrangement consideration is allocated to each of the following deliverables using the relative selling price method:

2. Significant Accounting Policies (continued)

- Licenses – licenses are issued for the use of existing patents;
- Release from litigation – the subsidiary of the Corporation releases the licensees from any claims or causes of action for patent infringement as of the effective date of the underlying agreement;
- Covenant-not-to-sue provision – the subsidiary of the Corporation agrees to a covenant-not-to-sue provision for infringement of any patents for a specified period commencing on the effective date of the underlying agreement.

As the license and release elements are fully delivered as of the effective date of the underlying agreement, revenue related to these elements is recognized at that time, assuming (i) there is persuasive evidence of an arrangement, (ii) the fee is fixed or determinable and (iii) there are no concerns over collectability of the arrangement proceeds. As the covenant-not-to-sue typically includes as-yet unidentified patents which may be acquired during the specified term (a when-and-if available deliverable), proceeds allocated to this element are recognized ratably over the specified period, assuming all other revenue recognition criteria have been met.

3. Change in Accounting Policy

EIC 175 does not differ materially from the application required under the FASB issued authoritative guidance on revenue arrangements that include certain software-related elements. Under the new FASB guidance, for arrangements that include software elements, tangible products with software components that are essential to the functionality of the tangible product will no longer be within the scope of the software revenue recognition guidance, and such software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, EIC 175 also does not differ materially from the application under the FASB issued authoritative guidance on multiple-deliverable revenue arrangements. Under the new FASB guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition.

During the quarter ended December 31, 2009, the Corporation early adopted the provisions of EIC 175 and retrospectively applied the guidance as at April 1, 2009. The effect of the retrospective adoption had no impact on amounts previously reported during the prior interim periods in the current fiscal year.

4. Recent accounting pronouncements

Business Combinations

In December 2008, CICA issued Section 1582 – "Business Combinations", which will replace Section 1581 – "Business Combinations". This section establishes revised standards for the accounting for a business combination which are aligned with International Financial Reporting Standards ("IFRS") on business combinations. The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. The Corporation has not yet determined what the impact of adopting this standard will have on the consolidated financial statements.

International Financial Reporting Standards

The Accounting Standards Board of the CICA announced that Canadian generally accepted accounting principles ("Canadian GAAP") for publicly accountable enterprises will be replaced with IFRS, as published by the International Accounting Standards Board, for fiscal years beginning on or after January 1, 2011. Early conversion to IFRS for fiscal years beginning on or after January 1, 2009 may also be permitted.

Implementing IFRS will have an impact on accounting, financial reporting and supporting IT systems and processes. It may also have an impact on taxes, contractual commitments involving clauses based on generally accepted accounting principles, long-term employee compensation plans and performance metrics. Accordingly, when the Corporation develops its IFRS implementation plan, it will have to include measures to provide extensive training to key finance personnel, to review contracts and agreements and to increase the level of awareness and knowledge among management, the Board of Directors and Audit Committee. Additional resources may be engaged to ensure the timely conversion to IFRS. The financial impact of the transition to IFRS cannot be reasonably estimated at this time.

4. Recent accounting pronouncements (continued)

Consolidated Financial Statements and Non-Controlling Interests

In January 2009, the CICA issued CICA Handbook Section 1601, "Consolidated Financial Statements" and Section 1602, "Non-controlling interest". Together these sections replace the former Section 1600, "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination and is equivalent to the corresponding provisions of International Financial Reporting Standard IAS 27, "Consolidated and Separate Financial Statements".

The new standards result in measuring business acquisitions at the fair value of the acquired business and a prospectively applied shift from a parent corporation conceptual view of consolidation theory (which results in the parent corporation recording book values attributable to non-controlling interests) to an entity conceptual view (which results in the parent corporation recording fair values attributable to non-controlling interests).

These sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011 and are to be applied prospectively. Earlier adoption is permitted as of the beginning of a fiscal year. An entity adopting these Sections for a fiscal year beginning before January 1, 2011 also adopts Section 1582, "Business Combinations".

The Corporation does not intend to early apply these sections. The impact on the Corporation's consolidated financial statements from the application of these sections will depend upon the nature of any future business acquisitions made by the Corporation after adoption.

Financial Instruments – Recognition and Measurement

On May 29, 2009, CICA's Accounting Standards Board ("AcSB") issued an Exposure Draft that proposes to amend CICA Handbook Section 3855, "Financial Instruments — Recognition and Measurement", to converge with international standards. The proposed amendment will have the following impact:

- The amendment clarifies that if an entity reclassifies a financial asset out of the held-for-trading category, it must assess whether the financial asset contains an embedded derivative that is required to be separated from the host contract. This assessment is made on the basis of circumstances that existed on the later date of specified dates provided in the amendment.

- If an embedded derivative cannot be measured reliably, the entity is prohibited from reclassifying the asset from held-for-trading.

- When a financial asset or a group of similar financial assets (other than the loans and receivables category) has been written down as a result of an impairment loss, interest income is recognized thereafter using the rate of interest used in the measurement of the impairment loss.

- An embedded call, put, surrender or prepayment option is closely related to the host debt instrument when its exercise price reimburses the lender for an amount up to the approximate present value of the lost interest. Calculation guidance to determine the lost interest is provided in the amendment.

The amendment is applicable for years ending on or after October 31, 2009 and will be applied prospectively. The adoption of this amendment did not have an impact on the Corporation's consolidated financial statements.

5. Foreign currency translation

Except as described below, the Corporation's functional and reporting currency is the United States dollar. Monetary assets and liabilities denominated in foreign currencies are translated in accordance with CICA Handbook Section 1651 "Foreign Currency Translation" ("Section 1651") (and the Financial Accounting Standards Board ("FASB") issued authoritative guidance regarding foreign currency translation) using the exchange rate prevailing at the balance sheet date and non-monetary assets and liabilities are translated at exchange rates prevailing at the historical transaction date. Average rates for the period are used to translate the Corporation's revenue and expenses. Gains and losses arising on settlement of foreign currency denominated transactions or balances are included in the determination of income.

The functional currency of the Corporation's Beanstream subsidiary is the Canadian dollar. Beanstream's financial statements are translated to United States dollars under the current rate method in accordance with Section 1651 and the FASB issued authoritative guidance regarding foreign currency translation. Beanstream's assets and liabilities are translated into U.S. dollars at rates of exchange in effect at the balance sheet date. Average rates for the period are used to translate Beanstream's revenues and expenses. Gains and losses arising on the translation of Beanstream's financial statements are reported as a cumulative translation adjustment which is a component of accumulated other comprehensive income.

6. Economic dependence

During the three months ended December 31, 2009, revenue from the Corporation's two largest customers amounted to approximately 22.7% of the Corporation's total revenue for the first customer (2008 – NIL%) and 12.1% for the second customer (2008 – 19.3%). Revenue from these customers amounted to approximately $1,077,113 for the first customer (2008 - $NIL) and $574,690 for the second customer (2008 - $585,500). The Corporation is economically dependent on revenue from the second customer as the revenue from the first customer is non-recurring.

During the nine months ended December 31, 2009, revenue from the Corporation's largest customer amounted to approximately 15.5% of total revenue (2008 – 18.5%). Revenue from this customer amounted to approximately $1,736,013 (2008 - $1,717,463). The Corporation is economically dependent on revenue from this customer.

7. Financial instruments

(a) The Corporation classifies its cash and cash equivalents, funds held in trust, funds held for merchants and restricted cash as held-for-trading. Accounts receivable are classified as loans and receivables. Accounts payable and certain accrued liabilities, funds due to merchants, and promissory notes are classified as other liabilities, all of which are measured at amortized cost (using the effective interest rate method).

Carrying value and fair value of financial assets and liabilities as at December 31, 2009 and March 31, 2009 are summarized as follows:

	December 31, 2009		March 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Held-for-Trading	$9,389,264	$9,389,264	$17,185,291	$17,185,291
Loans and receivables	756,967	756,967	801,087	801,087
Held-to-maturity	-	-	-	-
Available-for-sale	-	-	-	-
Other liabilities	5,779,922	5,779,922	14,418,590	14,418,590

Management reviewed all significant financial instruments held by the Corporation and determined that no material differences between fair value and carrying value existed as at the reporting date.

7. Financial Instruments (continued)

(b) Funds held in trust

During the three and nine month period ended December 31, 2009, $718,093 in cash was held in trust for a subsidiary of the Corporation by the Corporation's legal firm. This cash was received pursuant to a Settlement and License Agreement entered into by a subsidiary of the Corporation with one of the defendants in the patent infringement lawsuit originally filed on November 19, 2008 in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40220. Subsequent to the three and nine months ended December 31, 2009, the cash was released from trust to the subsidiary of the Corporation.

(c) 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, 2009 - $175,000) against chargeback losses. Non-current restricted cash represents funds held by a third party processor as security for the Corporation's merchant accounts.

(d) Market Risk

Currency Risk

The Corporation's functional currency is the U.S. dollar except for the Corporation's Beanstream subsidiary whose functional currency is the Canadian dollar. The Corporation is exposed to foreign exchange risk from fluctuations in exchange rates between the U.S. dollar and the Canadian dollar. Significant losses may occur due to significant balances of cash and cash equivalents and short-term investments held in Canadian dollars that may be affected negatively by an increase in the value of the U.S. dollar as compared to the Canadian dollar. The Corporation has not hedged its exposure to foreign currency fluctuations.

As at December 31, 2009 and March 31, 2009, the Corporation is exposed to currency risk through its cash and restricted cash, accounts receivable, accounts payable, accrued liabilities and promissory notes denominated in Canadian dollars as follows:

	December 31, 2009	March 31, 2009
Cash and restricted cash	$38,121	$1,172,539
Accounts receivable	-	50,476
Accounts payable	89,799	132,570
Accrued liabilities	282,518	333,360
Promissory notes	-	2,100,920

Based on the above foreign currency exposure as at December 31, 2009 and March 31, 2009 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 $33,420 and $134,384 respectively, in the Corporation's foreign currency loss/gain.

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 are short-term in nature and its promissory notes bear a fixed interest rate.

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.

7. Financial Instruments (continued)

(e) 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 December 31, 2009, the balance of the Corporation's allowance for doubtful accounts was $30,474 (March 31, 2009 - $31,785). The Corporation has good credit history with its customers and the amounts due from them generally are received as expected.

Pursuant to their respective terms, accounts receivable are aged as follows at December 31, 2009:

0-30 days	$668,478
31-60 days	81,755
61-90 days	5,973
Over 90 days due	31,235
	$787,441

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 and accounts receivable.

Cash and cash equivalents 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 December 31, 2009, three customers accounted for 22%, 20% and 14% of the Corporation's accounts receivable balance (March 31, 2009 – 16%, 26% and 3%).

(f) Liquidity Risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they are 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.

8. Cash and cash equivalents and funds held for /due to merchants

Cash and cash equivalents

At December 31, 2009, the Corporation held $3,979,487 (March 31, 2009: $6,138,530) in cash and cash equivalents. Included in this balance was $1 million in cash and cash equivalents used as continuing collateral security with the Corporation's primary financial institution which is available for use to the Corporation (March 31, 2009 - $1 million).

8. Cash and cash equivalents and funds held for /due to merchants (continued)

Funds held for/due to merchants

At December 31, 2009, the Corporation held funds due to merchants in the amount of $4,266,636 (March 31, 2009 - $10,746,731.) The funds held for/due to merchants were comprised of the following:

- funds held in reserves calculated by applying contractually determined percentages of the gross transaction volume for a hold-back period of up to nine months;
- funds from transaction payment processing which may be held for up to approximately fifteen days, the actual number of days depends on the contractual terms with each merchant; and
- funds from payroll/pre-authorized debit services provided on behalf of merchants, which may be held for up to approximately two days.

9. Stock-based compensation

The Corporation accounts for all stock options issued based on their fair value as required by the CICA Section 3870 which does not differ materially from the application required under the FASB issued authoritative guidance regarding share-based payment.

During the three months ended December 31, 2009, the Corporation granted 125,000 stock options under the Corporation's 2009 Stock Incentive Plan. The weighted average grant date fair value for these stock options is $0.44 per stock option. The fair value of these stock options was estimated at the date of grant using a Black-Scholes option-pricing model with the following assumptions:

Risk-free interest rate of 2.32%;

Expected volatility of 78.09%;

Expected life of the stock options of 4 years; and

No dividend yields.

During the three months ended September 30, 2009, the Corporation granted 75,000 stock options under the Corporation's 2009 Stock Incentive Plan and 300,000 stock options under the 1996 Stock Option Plan (no stock options were granted during the three month period ended June 30, 2009). The weighted average grant date fair value for these stock options is $0.38 per stock option. The fair value of these stock options was estimated at the date of grant using a Black-Scholes option-pricing model with the following assumptions:

Risk-free interest rate of 2.30%;

Expected volatility of 77.93%;

Expected life of the stock options of 4 years; and

No dividend yields.

During the nine months ended December 31, 2008, the Corporation did not grant any stock options under the Corporation's 1996 Stock Option plan, its 1998 Stock Incentive Plan or its 2009 Stock Incentive Plan.

10. Income Taxes

During the three and nine months ended December 31, 2009, the Corporation implemented certain tax planning strategies relating to its subsidiary, Beanstream. These strategies are expected to permit the recovery of income taxes previously paid on behalf of Beanstream. During the three months ended December 31, 2009, the Corporation recorded $324,275 in current income tax recovery. Future 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. During the three months ended December 31, 2009, we revised the value of the future tax assets pertaining to the Canadian non-capital loss carry-forwards as a result of newly available data and information. The Corporation decreased its future tax asset value resulting in a future income tax expense of $650,119 after application of the change in accounting estimate pertaining to the value of the Canadian non-capital loss carry-forwards available for future use. The change in accounting estimate has been applied prospectively from October 1, 2009.

11. Commitments and Contingencies

All commitments and contingencies remain unchanged from the Corporation's annual audited consolidated financial statements contained in the Corporation's Annual Report on Form 10-K for the fiscal year ended March 31, 2009 except as noted below:

During the three months ended December 31, 2009, a subsidiary of the Corporation entered into a Settlement and License Agreement (the "License Agreement") with one of the defendants (the "Released Defendant") in the patent infringement lawsuit originally filed on November 19, 2008 in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40220. The subsidiary of the Corporation sought damages, injunctive and other relief for the alleged infringement of this patent. The License Agreement was effective December 29, 2009 and provided the Released Defendant with a fully paid-up license to the subsidiary of the Corporation's patents for electronic check conversion transactions including "ARC", "WEB", "POP", "TEL" and "BOC". In connection with the License Agreement, the Released Defendant paid the subsidiary of the Corporation compensation in the amount of $1,150,000 for releases, licenses, covenants and all other rights granted under the License Agreement. Pursuant to a retention agreement with its legal firm, the subsidiary of the Corporation paid $288,175 in legal fees for the firm's services in connection with the License Agreement.

The License Agreement contained a number of elements that have been recorded in these consolidated financial statements under the guidance of EIC-175, which does not differ materially from the application required under the FASB issued authoritative guidance on revenue arrangements with multiple deliverables. Total arrangement consideration has been allocated to each of the following deliverables using the relative selling price method:

- Licenses – the subsidiary of the Corporation has issued a licence for the use of existing patents. This revenue has been recognized in the period.
- Release from litigation – the subsidiary of the Corporation has agreed to release the Released Defendant from any claims or causes of action for patent infringement as of the effective date. This revenue has been recognized in the period.
- Covenant-not-to-sue provision – the subsidiary of the Corporation has agreed to a covenant-not-to-sue provision for infringement of any patents for a specified period commencing on the effective date of the License Agreement. This revenue has been deferred and will be recognized ratably over the specified period.

12. 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 the subsidiary of the Corporation's intellectual property estate, which includes five U.S. patents describing electronic check processing methods.

Check Processing/Software Licensing ("CP/SL") operations involve primary and secondary check collection including electronic check re-presentment (RCK) and software licensing.

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. Asset information by operating segment is not reported to or reviewed by the Corporation's decision makers on an interim basis and therefore, the Corporation has not disclosed asset information for each operating segment.

Financial information for each reportable segment for the three and nine months ended December 31, 2009 and 2008 was as follows:

12. Industry and geographic segments (continued)

Three Months Ended December 31, 2009	TPP Canada	IPL U.S.	CP/SL U.S.	Reconciling Items		Consolidated Total
Total revenue	$2,674,557	$1,534,333	$533,678	$-		$4,742,568
Revenue: major customers	574,690	1,382,669	278,368	-		2,235,727
Cost of revenue	1,488,974	446,637	356,735	37,464	1	2,329,810
General and administrative	258,457	(30,315)	136,969	694,054	2	1,059,165
Sales and marketing	97,323	-	5,393	765	1	103,481
Product development and enhancement	110,526	-	-	12,233	1	122,759
Amortization and depreciation	15,628	41,857	13,657	129,204	3	200,346
Income (losses) before income taxes	$659,262	$1,076,596	$19,881	$(814,365)	4	$941,374

Three Months Ended December 31, 2008	TPP Canada	IPL U.S.	CP/SL U.S.	Reconciling Items		Consolidated Total
Total revenue	$1,948,747	$431,354	$657,140	$-		$3,037,241
Revenue: major customers	585,500	305,556	337,490	-		1,228,546
Cost of revenue	1,090,901	287	432,056	37,464	1	1,560,708
General and administrative	145,262	1,921	111,825	703,615	2	962,623
Sales and marketing	70,928	-	5,456	765	1	77,149
Product development and enhancement	46,046	-	-	12,233	1	58,279
Amortization and depreciation	10,729	42,057	15,481	128,835	3	197,102
Income (losses) before income taxes	$698,119	$398,738	$82,409	$(691,890)	4	$487,376

Nine months Ended December 31, 2009	TPP Canada	IPL U.S.	CP/SL U.S.	Reconciling Items		Consolidated Total
Total revenue	$7,060,499	$2,428,351	$1,740,923	$-		$ 11,229,773
Revenue: major customers	1,736,013	1,993,781	959,475	-		4,689,269
Cost of revenue	4,032,550	447,477	1,078,970	111,579	1	5,670,576
General and administrative	629,149	9,579	361,600	2,083,301	2	3,083,629
Sales and marketing	277,855	-	15,952	2,277	1	296,084
Product development and enhancement	306,151	-	-	36,434	1	342,585
Amortization and depreciation	42,761	125,820	40,658	387,691	3	596,930
(Gain) on sale of assets	-	-	(1,656)	(2,174)	5	(3,830)
Income (losses) before income taxes	$1,570,111	$1,846,769	$245,261	$(2,360,814)	4	$1,301,327

Nine months Ended December 31, 2008	TPP Canada	IPL U.S.	CP/SL U.S.	Reconciling Items		Consolidated Total
Total revenue	$5,873,518	$1,271,948	$2,156,221	$-		$9,301,687
Revenue: major customers	1,717,463	916,668	1,054,354	-		3,688,485
Cost of revenue	3,223,944	1,962	1,241,435	113,066	1	4,580,407
General and administrative	457,461	12,416	467,197	2,271,989	2	3,209,063
Sales and marketing	216,394	-	19,036	2,285	1	237,715
Product development and enhancement	161,022	-	-	36,567	1	197,589
Amortization and depreciation	31,617	126,143	48,378	383,516	3	589,654
(Gain) on sale of assets	-	-	(864)	-	5	(864)
Income (losses) before income taxes	$1,937,396	$1,165,728	$361,073	$(2,567,051)	4	$897,146

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[1] Represents stock-based compensation expense.
[2] Represents stock-based compensation expense 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 earnings (losses) included in the unallocated corporate or centralized marketing, general and administrative expenses.
[5] Represents (gain) on sale of assets included in the unallocated corporate or centralized marketing general and administrative expenses.

13. Reconciliation of United States to Canadian Generally Accepted Accounting Principles

These consolidated financial statements are prepared using Canadian GAAP, which does not differ materially from generally accepted accounting principles in the United States ("U.S. GAAP") with respect to the accounting policies and disclosures in these financial statements except as set out below:

(a) Under U.S. GAAP, the Corporation could not effect the reduction in deficit of $22,901,744 by reducing the stated capital of the shares of the Corporation's common stock.

(b) Income Taxes

In June 2006, the FASB issued authoritative guidance regarding accounting for uncertainty in income taxes. This guidance clarifies the recognition threshold and measurement of a tax position taken or expected to be taken on a tax return, and requires expanded disclosure with respect to the uncertainty in income taxes. The guidance also includes guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. The guidance is effective for fiscal years beginning after December 15, 2006.

The Corporation adopted the provisions of the guidance on April 1, 2007. No cumulative effect adjustment to the April 1, 2007 balance of the Corporation's deficit was required upon the implementation. As of the date of adoption there were no unrecognized tax benefits. Under current conditions and expectations, management does not foresee any significant changes in unrecognized tax benefits that would have a material impact on the Corporation's consolidated financial statements.

(c) Changes in U.S. GAAP

Recent accounting pronouncements affecting the Corporation's financial reporting under U.S. GAAP are summarized below:

(i) On July 1, 2009, the FASB established the new source of authoritative accounting principles, the FASB Accounting Standards Codification™ (the Codification). This new source of authoritative accounting principles recognized by the FASB is to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. Accounting Standards Updates will not be authoritative in their own right as they will serve to update the Codification. This adoption did not impact the Corporation's consolidated financial statements.

(ii) In September 2006, the FASB issued authoritative guidance which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The Corporation has fully adopted this guidance in the first quarter of fiscal 2010. Adoption of this guidance had no impact on the consolidated financial statements and the accompanying notes.

(iii) In December 2007, the FASB issued authoritative guidance regarding business combinations. This guidance is broader in scope than previous guidance that applied only to business combinations in which control was obtained by transferring consideration. The new guidance applies to all transactions and other events in which one entity obtains control over one or more other businesses. The new guidance is effective for fiscal years beginning after December 15, 2008. The Corporation has adopted the guidance as at April 1, 2009. Adoption of this guidance did not have an impact on the consolidated financial statements and the accompanying notes. The impact of this guidance will not be known until such time as the Corporation enters into a business combination, if ever.

(iv) In December 2007, the FASB issued authoritative guidance regarding non-controlling interest in consolidated financial statements. The new guidance changes the accounting for, and the financial statement presentation of, non-controlling equity interests in a consolidated subsidiary. The new guidance establishes non-controlling interests as a component of the equity of a consolidated entity.

The underlying principle of the new guidance is that both the controlling interest and the non-controlling interests are part of the equity of a single economic entity: the consolidated reporting entity. Classifying non-controlling interests as a component of consolidated equity is a change from the previous FASB issued authoritative guidance of treating minority interests as a mezzanine item between liabilities and equity or as a liability. The new guidance also changes the presentation of net income to include and identify net income attributable to the non-controlling interest. The change affects both the accounting and financial reporting for non-controlling interests in a consolidated subsidiary.

This guidance is effective for fiscal years and interim periods within those fiscal years beginning on or after December 15, 2008. The Corporation has adopted the guidance as at April 1, 2009. Adoption of this guidance has had no impact on the consolidated financial statements and the accompanying notes.

(v) In March 2008, the FASB changed its authoritative guidance regarding disclosures about derivative instruments and hedging activities. The changes in guidance require enhanced disclosures regarding derivatives and hedging activities, including: (a) the manner in which an entity uses derivative instruments; (b) the manner in which derivative instruments and related hedged items are accounted for and (c) the effect of derivative instruments and related hedged items on an entity's financial position, financial performance, and cash flows. This guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Corporation has adopted the guidance as at April 1, 2009. Adoption of this guidance has had no impact on the consolidated financial statements and the accompanying notes.

(vi) In April 2008, the FASB issued authoritative guidance regarding the determination of the useful life of intangible assets. This guidance removes the requirement to consider whether an intangible asset can be renewed without substantial cost of material modifications to the existing terms and conditions and, instead, requires an entity to consider its own historical experience in renewing similar arrangements. The guidance also requires expanded disclosure related to the determination of intangible asset useful lives. This guidance is effective for fiscal years beginning after December 15, 2008. The Corporation has adopted the guidance as at April 1, 2009. Adoption of this guidance has not had a material impact on the consolidated financial statements and the accompanying notes.

(vii) In April 2009, the FASB issued authoritative guidance regarding determining fair value when the volume and level of activity for the asset or liability have significantly decreased and identifying transactions that are not orderly. This guidance emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same, and provides additional guidance on when market level data should not be relied upon or should be adjusted in determining fair value. This guidance is effective for interim periods and fiscal years ending after June 15, 2009. The Corporation has adopted the guidance as at June 30, 2009. Adoption of this guidance has not had a material impact on the consolidated financial statements and the accompanying notes.

(viii) In April 2009, the FASB issued authoritative guidance regarding interim disclosures about fair value of financial instruments. This guidance functions to require, on an interim basis, disclosures about the fair value of financial instruments for public entities. This guidance is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Corporation has adopted the guidance as at June 30, 2009. Adoption of this guidance has had no material impact on the consolidated financial statements and the accompanying notes.

(ix) In May 2009, the FASB issued authoritative guidance regarding subsequent events. The new statement provides additional guidance on what events that occur subsequent to the balance sheet date will be recognized and/or disclosed. It also provides guidance on the date through which subsequent events have to be evaluated. This statement shall be effective for interim and annual financial periods ending after June 15, 2009, and shall be applied prospectively. The Corporation has adopted the guidance as at June 30, 2009. Adoption of this guidance has not had a material impact on the consolidated financial statements and the accompanying notes. The Corporation evaluated its December 31, 2009 financial statements for subsequent events through February 12, 2010, the date the financial statements were issued. The Corporation is not aware of any subsequent events that would require recognition or disclosure in the financial statements.

13. Reconciliation of United States to Canadian Generally Accepted Accounting Principles (continued)

(x) In October 2009, the FASB issued authoritative guidance on certain revenue arrangements that include software elements that is effective for fiscal years beginning on or after June 15, 2010, with earlier adoption permitted. Under the new guidance, tangible products that contain software components and non-software components that function together to deliver the tangible product's essential functionality and undelivered elements that relate to software that is essential to the functionality of the tangible product are not within the scope of the software revenue recognition guidance. The Corporation has early adopted this guidance in the quarter ended December 31, 2009 and retrospectively applied the guidance as at April 1, 2009. The effect of early adoption did not have an impact on amounts previously reported during the prior interim periods in the 2010 fiscal year.

(xi) In October 2009, the FASB issued authoritative guidance on multiple-deliverable revenue arrangements that is effective for fiscal years on or after June 15, 2010, with earlier adoption permitted. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements including, but not limited to, significant judgments made in applying the guidance and how changes in the judgments or in the application of the guidance may significantly affect either the timing or amount of revenue recognition. The Corporation has early adopted this guidance in the quarter ended December 31, 2009 and retrospectively applied the guidance as at April 1, 2009. The effect of early adoption did not have an impact on amounts previously reported during the prior interim periods in the 2010 fiscal year.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless the context otherwise requires, references in this report on Form 10-Q to the "Corporation", "LML", "we", "us" or "our" refer to LML Payment Systems Inc. and its direct and indirect subsidiaries. LML Payment Systems Inc.'s direct subsidiaries include Beanstream Internet Commerce Inc., LML Corp., Legacy Promotions Inc., 0858669 B.C. Ltd. and LHTW Properties 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.

The following discussion and analysis should be read in conjunction with the audited consolidated financial statements and related notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009, filed with the Securities and Exchange Commission on June 23, 2009 (file no. 000-13959). We believe that all necessary adjustments (consisting only of normal recurring adjustments) have been included in the amounts stated below to present fairly the following quarterly information. Quarterly operating results have varied significantly in the past and can be expected to vary in the future. Results of operations for any particular quarter are not necessarily indicative of results of operations for a full year.

Forward Looking Information

All statements other than statements of historical fact contained herein are forward-looking statements. Forward-looking statements generally are accompanied by words such as "anticipate," "believe," "estimate," "intend," "project," "potential" or "expect" or similar statements. The forward-looking statements were prepared on the basis of certain assumptions which relate, among other things, to the demand for and cost of marketing our services, the volume and total value of transactions processed by merchants utilizing our services, the technological adaptation of electronic check conversion end-users, the renewal of material contracts in our business, our ability to anticipate and respond to technological changes, particularly with respect to financial payments and e-commerce, in a highly competitive industry characterized by rapid technological change and rapid rates of product obsolescence, our ability to develop and market new product enhancements and new products and services that respond to technological change or evolving industry standards, no unanticipated developments relating to previously disclosed lawsuits against us, and the cost of protecting our intellectual property. Even if the assumptions on which the forward-looking statements are based prove accurate and appropriate, the actual results of our operations in the future may vary widely due to technological change, increased competition, new government regulation or intervention in the industry, general economic conditions, other risks described in our filings with the Securities and Exchange Commission. Accordingly, the actual results of our operations in the future may vary widely from the forward-looking statements included herein. All forward-looking statements included herein are expressly qualified in their entirety by the cautionary statements in this paragraph.

Overview

LML Payment Systems Inc. is a financial payment processor operating three separate lines of business: transaction payment processing, intellectual property licensing and check processing/software licensing. 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. We believe that electronic transaction processing services, including Internet-based payment services, will continue to be used in greater frequency than traditional payment methods, such as checks and cash, and we are therefore focusing on these services. Accordingly, we expect that our transaction payment processing services will be our principal line of business for the foreseeable future, while our other lines of business (including the electronic check processing services that we have historically relied on for a significant source of revenue) will become less important to our overall service offerings and less significant to the financial performance of our corporation.

TPP Segment

Our Transaction Payment Processing Operations ("TPP") 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. Gateway fees 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 8,000 customers primarily in Canada.

IPL Segment

Our Intellectual Property Licensing Operations ("IPL") involve licensing our intellectual property estate, which includes five U.S. patents describing electronic check processing methods. When we provide clients licenses to our intellectual property estate, we typically earn revenue from ongoing royalty fees and, in some cases, release fees for potential past infringement. In some instances we also earn revenue from license agreements that provide for the payment of contractually determined paid-up license fees to us in consideration for the grant of a non-exclusive, retroactive and future license to our intellectual property estate and in other instances, where license agreements include multiple element arrangements, we may defer portions of this revenue and recognize the revenue ratably over the license term.

CP/SL Segment

Our CP/SL operations involve primary and secondary check collection including electronic check re-presentment (RCK) and software licensing. Our check processing services involve check return management such as traditional and electronic recovery services to retail clients. When we provide return check management services, 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.

We also provide mainframe payment processing software modules and rights to use our intellectual property to retailers and other payment processors. When we provide mainframe based payment software modules we typically earn revenue by way of a fixed software license fee. In some instances we also earn revenue by way of royalties that are typically based upon a fixed sale price or on a usage or transaction basis.

Within these segments, performance is measured based on revenue, factoring in interest income and expenses and amortization and depreciation as well as 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. Asset information by operating segment is not reported to or reviewed by our senior management decision makers on an interim basis, and therefore we have not disclosed asset information for each operating segment.

Results of Operations

Three months ended December 31, 2009 compared to three months ended December 31, 2008

Revenue

Total revenue for the three months ended December 31, 2009 was approximately $4,743,000, an increase of approximately $1,706,000 or approximately 56.2% from total revenue of approximately $3,037,000 for the three months ended December 31, 2008. This increase is primarily attributable to an increase in IPL revenues for the period of approximately $1,103,000 and partially attributable to an increase in TPP revenues of approximately $726,000.

During the three months ended December 31, 2009 revenue from and associated with our two largest customers amounted to approximately 34.8% of total revenue as compared to approximately 19.3% of total revenue for the three months ended December 31, 2008. The increase in the percentage of revenue from and associated with our two largest customers to total revenue is primarily attributable to an increase in our IPL revenue associated with one customer, representing 22.7% of total revenue, during the three months ended December 31, 2009. We are economically dependent on revenue from one of these customers representing 12.1% of total revenue (2008 – 19.3%) as revenue from the other customer is non-recurring. The temporary or permanent loss of this customer might have a material adverse effect on our results of operations and financial condition.

TPP Segment

Revenue pertaining to our TPP segment consists of one-time set-up fees, monthly gateway fees, transaction fees and software customization fees. TPP segment revenue for the three months ended December 31, 2009 was approximately $2,675,000, an increase of approximately $726,000 or approximately 37.3% from TPP segment revenue of approximately $1,949,000 for the three months ended December 31, 2008. The increase in TPP segment revenue was primarily attributable to software customization fee revenue of approximately $214,000 recognized during the current period.

Transaction fees for the three months ended December 31, 2009 were approximately $2,042,000 compared to approximately $1,588,000 for the three months ended December 31, 2008, an increase of approximately $454,000 or approximately 28.5%. The increase in transaction fees was primarily attributable to a strengthening Canadian dollar in relation to the U.S. dollar which increased approximately 12% from the prior fiscal third quarter. Since a significant amount of our TPP segment revenue originates in Canadian dollars, the conversion of this revenue to U.S. dollars was at an increased exchange rate when compared to the prior fiscal third quarter conversion. Transaction fees originating in Canadian dollars were approximately $2,159,000CAD for the three months ended December 31, 2009 compared to $1,926,000CAD for the three months ended December 31, 2008, an increase of approximately $233,000 or approximately 12.1%. The amortized portion of one-time set-up fees recognized was approximately $46,000 for the three months ended December 31, 2009 compared to approximately $35,000 for the three months ended December 31, 2008, an increase of approximately $11,000 or approximately 31.4%. Monthly gateway fees for the three months ended December 31, 2009 were approximately $318,000 compared to approximately $243,000 for the three months ended December 31, 2008, an increase of approximately $75,000 or approximately 30.9%.

IPL Segment

Revenue from licensing our patented intellectual property increased by approximately $1,103,000 or approximately 256%, from approximately $431,000 for the three months ended December 31, 2008 to approximately $1,534,000 for the three months ended December 31, 2009. The increase in revenue from licensing our patented intellectual property was primarily attributable to the net licensing revenue recognized of approximately $1,077,000 from the License Agreement entered into during the three months ended December 31, 2009 and partially attributable to an increase of approximately $26,000 in licensing revenue related to aggregate licenses providing running royalties and other paid up license fees.

CP/SL Segment

CP/SL segment revenue for the three months ended December 31, 2009 was approximately $534,000, a decrease of approximately $123,000 or approximately 18.7% from CP/SL segment revenue of approximately $657,000 for the three months ended December 31, 2008. The decrease in CP/SL segment revenue was primarily attributable to a reduction in revenue from our primary and secondary check collections business.

Revenue from our primary check collections business decreased approximately 26.5% from approximately $117,000 for the three months ended December 31, 2008 to approximately $86,000 for the three months ended December 31, 2009. Revenue from our secondary check collections business decreased approximately 17.5% from approximately $509,000 for the three months ended December 31, 2008 to approximately $420,000 for the three months ended December 31, 2009. The decrease in primary and secondary check collections business is primarily attributable to a reduction of approximately 20.5% in returned checks for primary collections business and partially attributable to a reduction in collections of the principal amount and related fees of returned checks assigned for secondary recovery. We believe as consumers continue to use checks less as a method of payment in favor of other methods of payment, particularly electronic forms of payments including debit and credit cards, the value of returned checks available for our primary and secondary check collections business may continue to decrease. We anticipate developing plans to increase the volume of returned checks in addition to developing plans to decrease expenses associated with this segment.

Cost of Revenue

Cost of revenue consists primarily of costs incurred by the TPP and CP/SL operating segments and partially of costs incurred by the IPL operating segment. These costs are incurred in the delivery of e-commerce transaction services, customer service support and check collection services and include processing and interchange fees paid, other third-party fees, personnel costs and associated benefits and stock-based compensation. IPL segment costs of revenue are primarily legal retention fees and disbursement costs incurred in generating licensing revenue.

Cost of revenue increased from approximately $1,561,000 for the three months ended December 31, 2008, to approximately $2,330,000 for the three months ended December 31, 2009, an increase of approximately $769,000 or approximately 49.3%. The increase was primarily attributable to an increase in our TPP segment cost of revenue of approximately $398,000 or approximately 36.5% from approximately $1,091,000 for the three months ended December 31, 2008 to approximately $1,489,000 for the three months ended December 31, 2009 and an increase in IPL segment cost of revenue of approximately $447,000 from approximately $NIL for the three months ended December 31, 2008 to approximately $447,000 for the three months ended December 31, 2009. The increase in TPP segment cost of revenue was primarily attributable to a strengthening Canadian dollar in relation to the U.S. dollar which increased approximately 12% from the prior fiscal third quarter. Since a significant amount of our TPP segment cost of revenue originates in Canadian dollars, the conversion of these costs to U.S. dollars was at an increased exchange rate when compared to the prior fiscal third quarter conversion. TPP segment costs of revenue originating in Canadian dollars was approximately $1,574,000CAD for the three months ended December 31, 2009 compared to $1,323,000CAD for the three months ended December 31, 2008, an increase of approximately $251,000 or approximately 19%. The increase in IPL segment cost of revenue was primarily attributable to the costs incurred in entering into the License Agreement during the three months ended December 31, 2009.

General and administrative expenses

General and administrative expenses consist primarily of personnel costs including associated stock-based compensation and employment benefits, office facilities, travel, public relations and professional service fees, which include legal fees, audit fees, SEC compliance costs and costs related to compliance with the Sarbanes-Oxley Act of 2002. 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 to approximately $1,059,000 from approximately $963,000 for the three months ended December 31, 2009 and 2008, respectively, an increase of approximately $96,000 or approximately 10%. Included in general and administrative expenses are TPP segment expenses of approximately $258,000 for the three months ended December 31, 2009, an increase of approximately $113,000 compared to general and administrative expenses of approximately $145,000 for the three months ended December 31, 2008. The increase in TPP segment general and administrative expenses is primarily attributable to the foreign exchange effect of a strengthening Canadian dollar in relation to the U.S. dollar which increased approximately 12% from the prior fiscal third quarter. CP/SL segment expenses increased to approximately $137,000 from approximately $112,000 for the three months ended December 31, 2009 and 2008, respectively, an increase of approximately $25,000 or approximately 22.3%.

Sales and Marketing

Sales and marketing expenses consist primarily of costs related to sales and marketing activities. These expenses include salaries, 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 increased to approximately $103,000 from approximately $77,000 for the three months ended December 31, 2009 and 2008, respectively, an increase of approximately 33.8%. The increase is primarily attributable to an increase of approximately $26,000 in TPP segment sales and marketing expenses from approximately $71,000 for the three months ended December 31, 2008 to approximately $97,000 for the three months ended December 31, 2009. The increase in TPP segment sales and marketing expenses is primarily attributable to the foreign exchange effect of a strengthening Canadian dollar in relation to the U.S. dollar which increased approximately 12% from the prior fiscal third quarter and partially attributable to an increase in wages and commissions of approximately $15,000 CAD.

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 improving and enhancing of the existing product and service lines.

Product development and enhancement expenses were approximately $123,000 for the three months ended December 31, 2009 as compared to $58,000 for the three months ended December 31, 2008. This increase is primarily attributable to an increase in TPP segment product development and enhancement expenses of approximately $65,000 or approximately 141.3% from approximately $46,000 for the three months ended December 31, 2008 to approximately $111,000 for the three months ended December 31, 2009. The increase in TPP product development and enhancement expenses is primarily attributable to an increase in staffing levels for the three months ended December 31, 2009 as compared to the three months ended December 31, 2008.

Amortization and Depreciation

Amortization and depreciation increased to approximately $200,000 from approximately $197,000 for the three months ended December 31, 2009 and 2008, respectively, an increase of approximately $3,000 or approximately 1.5%.

Interest income

Interest income decreased to approximately $4,000 from approximately $59,000 for the three months ended December 31, 2009 and 2008, respectively. The decrease in interest income was primarily attributable to a decrease in interest bearing cash investments and a decrease in interest rates earned on cash investments.

Interest expense

Interest expense decreased to approximately $1,000 from approximately $45,000 for the three months ended December 31, 2009 and 2008, respectively. The decrease is primarily attributable to the payment of the final installment of approximately $2,321,000 on the promissory notes relating to the acquisition of Beanstream which was made in the first quarter of fiscal 2010.

Income tax expense (recovery)

Income tax expense (recovery) consists of a recovery of current income taxes of approximately $324,000 for the three months ended December 31, 2009 compared to an income tax expense of approximately $206,000 for the three months ended December 31, 2008, a decrease of current income tax expense of approximately $530,000. The decrease is primarily attributable to the expected recovery of taxes for the current fiscal quarter resulting from the implementation of certain tax planning strategies during the three months ended September 30, 2009. These strategies are intended to permit the recovery of income taxes previously paid on behalf of our subsidiary, Beanstream. Future income tax expense was approximately $650,000 for the three months ended December 31, 2009 compared to $NIL for the three months ended December, 31, 2008, an increase in future income tax expense of approximately $650,000. The increase in future income tax expense was primarily attributable to a decrease in the future tax asset value as at December 31, 2009.

Net income

Net income increased by approximately $335,000 from net income of approximately $281,000 for the three months ended December 31, 2008 to approximately $616,000 for the three months ended December 31, 2009.

Basic and diluted earnings per share were both approximately $0.02 for the three months ended December 31, 2009, as compared to approximately $0.01 for the three months ended December 31, 2008.

Results of Operations

Nine months ended December 31, 2009 compared to nine months ended December 31, 2008

Revenue

Total revenue for the nine months ended December 31, 2009 was approximately $11,230,000, an increase of approximately $1,928,000 or approximately 20.7% from total revenue of approximately $9,302,000 for the nine months ended December 31, 2008. This increase is primarily attributable to the increase in our TPP segment revenue of approximately $1,186,000 or approximately 20.2%, from approximately $5,874,000 for the nine months ended December 31, 2008 to approximately $7,060,000 for the nine months ended December 31, 2009 and an increase in our IPL segment revenue of approximately $1,156,000 or approximately 90.9% from approximately $1,272,000 to approximately $2,428,000.

During the nine months ended December 31, 2009 revenue from and associated with our largest customer amounted to approximately 15.5% of total revenue as compared to approximately 18.5% of total revenue for the nine months ended December 31, 2008. The decrease in the percentage of revenue from and associated with our largest customer to total revenue is primarily attributable to our total revenue increasing approximately 20.7% from total revenue of the prior fiscal nine month period resulting from an increase in our TPP and IPL segment revenue. We are economically dependent on revenue from this customer and the temporary or permanent loss of this customer might have a material adverse effect on our results of operations and financial condition.

TPP Segment

Revenue pertaining to our TPP segment consists of one-time set-up fees, monthly gateway fees, transaction fees and software customization fees. TPP segment revenue for the nine months ended December 31, 2009 was approximately $7,060,000 as compared to TPP segment revenue of approximately $5,874,000 for the nine months ended December 31, 2008, an increase of approximately $1,186,000 or approximately 20.2%.

Transaction fees for the nine months ended December 31, 2009 were approximately $5,638,000 compared to transaction fees of approximately $4,765,000 for the nine months ended December 31, 2008, an increase of approximately $873,000 or approximately 18.3%. The amortized portion of one-time set-up fees recognized was approximately $121,000 for the nine months ended December 31, 2009 compared to one-time set-up fees for the nine months ended December 31, 2008 of approximately $106,000, an increase of approximately $15,000 or approximately 14.2%. Monthly gateway fees for the nine months ended December 31, 2009 were approximately $874,000 compared to monthly gateway fees for the nine months ended December 31, 2008 of approximately $741,000, an increase of approximately $133,000 or approximately 17.9%. The increase in transaction fees, one-time set-up fees and monthly gateway fees was primarily attributable to a 13.7% increase in new customer contracts during the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008.

IPL Segment

Revenue from licensing our patented intellectual property increased by approximately $1,156,000 or approximately 90.9%, from approximately $1,272,000 for the nine months ended December 31, 2008 to approximately $2,428,000 for the nine months ended December 31, 2009. The increase in revenue from licensing our patented intellectual property was primarily attributable to the revenue recognized of approximately $1,077,000 from the License Agreement entered into during the nine months ended December 31, 2009 and partially attributable to an increase of approximately $79,000 in licensing revenue related to aggregate licenses providing running royalties and other paid up license fees.

CP/SL Segment

CP/SL segment revenue for the nine months ended December 31, 2009 was approximately $1,741,000, a decrease of approximately $415,000 or approximately 19.2% from CP/SL segment revenue of approximately $2,156,000 for the nine months ended December 31, 2008.

Revenue from our primary check collections business decreased approximately $67,000 or approximately 18.2% from approximately $368,000 for the nine months ended December 31, 2008 to approximately $301,000 for the nine months ended December 31, 2009. Revenue from our secondary check collections business decreased approximately $230,000 or approximately 14.5% from approximately $1,586,000 for the nine months ended December 31, 2008 to approximately $1,356,000 for the nine months ended December 31, 2009. The decrease in primary and secondary check collections business is primarily attributable to a reduction in returned checks for primary collections business and a reduction in collections of the principal amount and related fees of returned checks assigned for secondary recovery.

Cost of Revenue

Cost of revenue consists primarily of costs incurred by the TPP and CP/SL operating segments. These costs are incurred in the delivery of e-commerce transaction services, customer service support and check collection services and include processing and interchange fees paid, other third-party fees, personnel costs and associated benefits and stock-based compensation. IPL segment costs of revenue are primarily legal retention fees and legal disbursement costs incurred in generating licensing revenue.

Cost of revenue increased from approximately $4,580,000 for the nine months ended December 31, 2008, to approximately $5,671,000 for the nine months ended December 31, 2009, an increase of approximately $1,091,000 or approximately 23.8%. This increase was primarily attributable to an increase in TPP segment cost of revenue of approximately $809,000 or approximately 25.1%, from approximately $3,224,000 for the nine months ended December 31, 2008 to approximately $4,033,000 for the nine months ended December 31, 2009. The increase in TPP segment cost of revenue was primarily attributable to an increase in our transaction costs which include interchange, assessments and other transaction fees and partially attributable to an increase in staffing within our customer service support team. CP/SL segment cost of revenue was approximately $1,079,000 for the nine months ended December 31, 2009 as compared to approximately $1,241,000 for the nine months ended December 31, 2008, a decrease in CP/SL segment cost of revenue of approximately $162,000 or approximately 13.1%. IPL segment cost of revenue was approximately $447,000 for the nine months ended December 31, 2009, as compared to approximately $2,000 for the nine months ended December 31, 2008, an increase in IPL segment cost of revenue of approximately $445,000. The increase in IPL segment cost of revenue was primarily attributable to the costs incurred in entering into the License Agreement during the nine months ended December 31, 2009.

General and administrative expenses

General and administrative expenses consist primarily of personnel costs including associated stock-based compensation and employment benefits, office facilities, travel, public relations and professional service fees, which include legal fees, audit fees, SEC compliance costs and costs related to compliance with the Sarbanes-Oxley Act of 2002. 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 decreased to approximately $3,084,000 from approximately $3,209,000 for the nine months ended December 31, 2009 and 2008, respectively, a decrease of approximately $125,000 or approximately 3.9%. Included in general and administrative expenses for the nine months ended December 31, 2009 are TPP segment expenses of approximately $629,000 as compared to approximately $457,000 for the nine months ended December 31, 2008. The increase in TPP segment general and administrative expenses was primarily attributable to an increase in accounting and legal fees, bank charges and interest expense of approximately $127,000 collectively. CP/SL segment expenses decreased to approximately $362,000 from approximately $467,000 for the nine months ended December 31, 2009 and 2008, respectively, a decrease of approximately $105,000 or approximately 22.5%. The decrease in CP/SL segment general and administrative expenses is primarily attributable to staff reductions and cost savings relating to the relocation of our Wichita, Kansas office during the third quarter of our prior fiscal year. Also included in general and administrative expenses are stock-based compensation expenses of approximately $781,000 for the nine months ended December 31, 2009 compared to approximately $871,000 for the nine months ended December 31, 2008, a decrease of approximately $90,000 or approximately 10.3%.

Sales and Marketing

Sales and marketing expenses consist primarily of costs related to sales and marketing activities. These expenses include salaries, 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 increased to approximately $296,000 from approximately $238,000 for the nine months ended December 31, 2009 and 2008, respectively, an increase of approximately $58,000 or approximately 24.4%. The increase is primarily attributable to an increase in our TPP segment sales and marketing expenses of approximately $62,000 from approximately $216,000 for the nine months ended December 31, 2008 to approximately $278,000 for the nine months ended December 31, 2009. The increase in TPP segment sales and marketing expenses is primarily attributable to an increase in wages and commissions of approximately $54,000.

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 improving and enhancing of the existing product and service lines.

Product development and enhancement expenses were approximately $343,000 for the nine months ended December 31, 2009 as compared to approximately $198,000 for the nine months ended December 31, 2008. The increase is primarily attributable to an increase in our TPP segment product development and enhancement expenses of approximately $145,000, or approximately 90%, from approximately $161,000 for the nine months ended December 31, 2008 to approximately $306,000 for the nine months ended December 31, 2009. The increase in TPP product development and enhancement expenses is primarily attributable to an increase in staffing levels for the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008.

Amortization and Depreciation

Amortization and depreciation increased to approximately $597,000 from approximately $590,000 for the nine months ended December 31, 2009 and 2008, respectively, an increase of approximately $7,000 or approximately 1.2%.

Interest income

Interest income decreased to approximately $21,000 from approximately $203,000 for the nine months ended December 31, 2009 and 2008, respectively. The decrease in interest income was primarily attributable to a decrease in interest bearing cash investments and a decrease in interest rates earned on cash investments.

Interest expense

Interest expense decreased to approximately $48,000 from approximately $204,000 for the nine months ended December 31, 2009 and 2008, respectively. The decrease is primarily attributable to the payment of the final installment of approximately $2,321,000 on the promissory notes relating to the acquisition of Beanstream which was made in the first quarter of fiscal 2010.

Income tax expense (recovery)

Income tax expense (recovery) consists of a recovery of current income taxes of approximately $324,000 for the nine months ended December 31, 2009 compared to an income tax expense of approximately $597,000 for the nine months ended December 31, 2008, a decrease of current income tax expense of approximately $921,000. The decrease is primarily attributable to the expected recovery of taxes for the current fiscal period resulting from the implementation of certain tax planning strategies during the nine months ended December 31, 2009. These strategies are intended to permit the recovery of income taxes previously paid on behalf of our subsidiary, Beanstream. Future income tax expense was approximately $554,000 for the nine months ended December 31, 2009 compared to $NIL for the nine months ended December 31, 2008, an increase in future income tax expense of approximately $554,000. The increase in future income tax expense was primarily attributable to a decrease in the future tax asset value as at December 31, 2009.

Net income

Net income increased approximately $771,000 from net income of approximately $300,000 for the nine months ended December 31, 2008 to approximately $1,071,000 for the nine months ended December 31, 2009.

Basic and diluted earnings per share were both approximately $0.04 for the nine months ended December 31, 2009, as compared to basic and diluted earnings per share of approximately $0.01 for the nine months ended December 31, 2008.

Liquidity and Capital Resources

Our liquidity and financial position consisted of approximately $5,511,000 in working capital as of December 31, 2009 compared to approximately $2,762,000 in working capital as of March 31, 2009, an increase of approximately $2,749,000. The increase in working capital was primarily attributable to an increase in the current portion of future income taxes of approximately $1,014,000 resulting from the implementation of tax planning strategies during the nine months ended December 31, 2009. These strategies are intended to permit the recovery of income taxes previously paid on behalf of our subsidiary, Beanstream. Cash provided by operating activities was approximately $175,000 for the nine months ended December 31, 2009, as compared to cash used in operating activities of approximately $584,000 for the nine months ended December 31, 2008, an increase in cash generated by operating activities of approximately $759,000. The increase in cash provided by operating activities was primarily attributable to a decrease in cash used in discharging accounts payable and accrued liabilities of approximately $71,000 for the nine months ended December 31, 2009 as compared to cash used in discharging accounts payable and accrued liabilities of approximately $802,000 for the nine months ended December 31, 2008. Cash used in investing activities was approximately $86,000 for the nine months ended December 31, 2009 as compared to approximately $102,000 for the nine months ended December 31, 2008, a decrease in cash used in investing activities of approximately $16,000. The decrease in cash used in investing activities was primarily attributable to a decrease in acquisition of property and equipment of approximately $16,000 for the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008. Cash used in financing activities was approximately $2,462,000 for the nine months ended December 31, 2009 as compared to approximately $2,990,000 for the nine months ended December 31, 2008, a decrease in cash used in financing activities of approximately $528,000. The decrease in cash used in financing activities was primarily due to the difference in the payments on the promissory notes relating to the acquisition of Beanstream. During the nine months ended December 31, 2009 we made the second and final payment of approximately $2,321,000 on the promissory notes as compared to the first payment of approximately $2,844,000 on the promissory notes made during the nine months ended December 31, 2008, a difference in payments of approximately $523,000.

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 December 31, 2009, 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 (as demonstrated by our acquisition of Beanstream), 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.

Recently Adopted Accounting Guidance

In December 2009, CICA's EIC issued an Abstract of Issues Discussed, "Multiple Deliverable Revenue Arrangements", which does not differ materially from the FASB authoritative guidance on revenue recognition issued in October 2009. We have early adopted this guidance during the quarter ended December 31, 2009 and retrospectively applied the guidance as at April 1, 2009. Under the FASB's new guidance on arrangements that contain software components and non-software components that function together to deliver the tangible product's essential functionality and undelivered elements that relate to software that is essential to the functionality of the tangible product are not within the scope of the software revenue recognition guidance. Additionally, the FASB issued authoritative guidance on multiple-deliverable revenue arrangements. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements, including, but not limited to significant judgments made in applying the guidance and how changes in judgments or in the application of the guidance may significantly affect either the timing or amount of revenue recognition. We have also early adopted both of the FASB's new guidance during the quarter ended December 31, 2009 and retrospectively applied the guidance as at April 1, 2009. The effect of early adoption of this guidance did not impact any amounts previously reported during the prior interim periods in the 2010 fiscal year.

Critical Accounting Policies

There have been no changes to our critical accounting policies since March 31, 2009. For a description of our critical accounting policies, see our Annual Report on Form 10-K for the year ended March 31, 2009 filed with the Securities and Exchange Commission on June 23, 2009 (file no. 000-13959).

Contingencies

LML Patent Corp., our indirect wholly-owned subsidiary, entered into a Settlement and License Agreement (the "License Agreement") with one of the defendants (the "Released Defendant") in the patent infringement lawsuit originally filed by LML Patent Corp. in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40220. LML Patent Corp. sought damages, injunctive and other relief for the alleged infringement of this patent. The License Agreement was effective December 29, 2009 and provided the Released Defendant with a fully paid-up license to LML Patent Corp's patents for electronic check conversion transactions including "ARC", "WEB", "POP", "TEL" and "BOC". In connection with the License Agreement, the Released Defendant paid LML Patent Corp. compensation in the amount of $1,150,000 for releases, licenses, covenants and all other rights granted under the License Agreement. Pursuant to the License Agreement, the lawsuit against the Released Defendant was dismissed with prejudice on January 5, 2010.

In addition to legal matters described herein and as previously reported in our Annual Report filed on Form 10-K for the year ended March 31, 2009, as filed with the Securities and Exchange Commission on June 23, 2009 (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 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

From March 31, 2009 until December 31, 2009, 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, 2009, as filed with the Securities and Exchange Commission on June 23, 2009 (file no. 000-13959).

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. As required by Rule 13a-15(b) under the Securities and Exchange Act of 1934 (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 is 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 this evaluation our CEO and CAO concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective 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. 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

LML Patent Corp., our indirect wholly-owned subsidiary, entered into a Settlement and License Agreement (the "License Agreement") with RBS Citizens Bank N.A. (the "Released Defendant"), one of the defendants in the patent infringement lawsuit originally filed by LML Patent Corp. in the U.S. District Court for the Eastern District of Texas against nineteen defendants in the United States alleging that the defendants infringe U.S. Patent No. RE40220. LML Patent Corp. sought damages, injunctive and other relief for the alleged infringement of this patent (the "Patent Litigation"). The License Agreement was effective December 29, 2009 and provided the Released Defendant with a fully paid-up license to LML Patent Corp.'s patents for electronic check conversion transactions including "ARC", "WEB", "POP", "TEL" and "BOC". In connection with the License Agreement, the Released Defendant paid LML Patent Corp. compensation in the amount of $1,150,000 for releases, licenses, covenants and all other rights granted under the License Agreement. Pursuant to the License Agreement, the lawsuit against the Released Defendant was dismissed with prejudice on January 5, 2010.

In addition to the legal matters described herein and as previously reported in our Annual Report on Form 10-K for the year ended March 31, 2009, as filed with the Securities and Exchange Commission on June 23, 2009 (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, 2009, as filed with the Securities and Exchange Commission on June 23, 2009 (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, 2006 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)).
10.1*†	Settlement and License Agreement between LML Patent Corp. and RBS Citizens Bank N.A. dated December 29, 2009.
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

† Portions of this exhibit have been omitted pursuant to a request for confidential treatment.

LML PAYMENT SYSTEMS INC.

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

LML PAYMENT SYSTEMS INC.

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

February 12, 2010

Exhibit 10.1

SETTLEMENT AND LICENSE AGREEMENT

This Settlement and License Agreement (the "Agreement") is entered into by LML Patent Corp., ("LML") and The Royal Bank of Scotland plc. ("RBS"). LML and RBS are individually referred to as "Party" and collectively as the "Parties." This Agreement is effective as of the 29th day of December, 2009 ("Effective Date").

RECITALS

WHEREAS, LML owns rights in certain U.S. Patents related to making, using, offering for sale and selling Electronic Check Conversion systems and services;

WHEREAS, LML began an action against RBS and other defendants in the United States District Court for the Eastern District of Texas, Marshall Division, 2-08-CV-448-DF ("Litigation I") and 2-09-CV-180-TJW ("Litigation II") (collectively, the "Lawsuits"), alleging infringement of LML's U.S. Patent No. RE40,220; and

WHEREAS, the Parties have reached a settlement of their dispute, and RBS desires to license LML's patents;

NOW, THEREFORE, in consideration of the covenants contained in this Agreement and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

1. DEFINITIONS.

The following definitions apply to this Agreement:

(a) "ACH" is the acronym for the "Automated Clearing House" Network and means the electronic payment network regulated by the National Automated Clearing House Association ("NACHA").

(b) "ACH File" means the electronic transaction that results from ECC and includes NACHA standard entry class codes ARC, WEB, POP, TEL, and BOC.

(c) "Affiliate" means any person or entity that directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, such Party, where "control" means ownership of fifty percent (50%) or more of the capital stock or other ownership interest of the person or entity carrying the right to vote for or appoint directors or their equivalent (if not a corporation).

(d) "Court" means the United States District Court for the Eastern District of Texas, Marshall Division.

(e) "Customer" means any person or entity that purchases or receives Licensed Products and Services directly from Licensee. Specifically excluded from this definition are (1) Defendants, (2) banks, banking institutions and payment processing companies, and (3) any person or entity that purchases or receives Licensed Products and Services directly from Licensee on behalf of a bank, banking institution, or payment processing company.

(f) "Defendant" means any defendant named in the Lawsuits and any Affiliate of such defendant.

(g) "ECC" is the acronym for "Electronic Check Conversion" and means the process or system by which a paper check is converted to an electronic transaction.

(h) "Licensed Products and Services" means products or services of RBS that create, process, or transmit ACH Files that RBS originates, receives from Third Party Converters and/or receives or generates on behalf of Customers, and that practice one or more claims of the LML Patents.

(i) "Licensee" means RBS and its Affiliates as of the Effective Date.

(j) "LML Patents" means (i) U.S. Patent No. RE40,220, (ii) any issued patent and any pending patent application anywhere in the world that LML currently owns or controls (or has the right to own or control) as of the Effective Date of this Agreement; (iii) any patent or application to which any of the foregoing patents and/or patent applications claims priority, and (iv) any continuations, continuations in part, reissues, reexamination certificates, and/or divisional applications of the foregoing patents and/or patent applications described above.

(k) "Third Party Converter" means any person or entity that creates or processes ACH Files on behalf of RBS and transmits those ACH Files to RBS for the purpose of further transmission to the ACH Network (as part of an ACH pass-through transaction) using the Licensed Products and Services. Specifically excluded from this definition are (1) Defendants, (2) banks and banking institutions, and (3) any person or entity that creates or processes ACH Files on behalf of any bank or banking institution other than RBS, and that transmits those ACH Files to RBS for the purpose of further transmission to the ACH Network (as part of an ACH pass-through transaction) using the Licensed Products and Services.

2. SETTLEMENT OF THE LITIGATION.

2.1 Stipulated Dismissal. The Parties agree to direct their counsel to file with the Court a joint motion for dismissal with prejudice of the Parties' respective claims for relief in Litigation I within five (5) days after the receipt of payment specified in Section 3.1.

2.2 No Award of Fees or Costs. The Parties agree that they shall bear their own costs and attorneys' fees relating to Litigation I.

2.3 No Attempt to Invalidate. Licensee agrees that, in the absence of a subpoena or court order requiring its participation or support, it shall not take any action, participate in or support any suit, claim, action, litigation, administrative proceeding, or proceeding of any nature brought by or against LML that concerns or challenges the validity or enforceability of the LML Patents, unless such suit, claim, action, litigation or proceeding to enforce one or more of the LML Patents is brought by LML or its successors, assigns, Affiliates, or licensees against Licensee, or places Licensee in a reasonable apprehension of being sued on one or more of the LML Patents.

3. PAYMENT AND TERMINATION

3.1 Payment by Licensee. Licensee agrees to pay to LML the sum of one million one hundred fifty thousand U.S. dollars ($1,150,000.00) within ten (10) business days following the Effective Date. The amount will be delivered to LML's counsel, McKool Smith P.C., via wire transfer to the following account:

Bank: Inwood National Bank
Address: 7621 Inwood Road, Dallas, TX 75209
Acct# [******]
ABA# [******]
Account Name: McKool Smith IOLTA Trust Account

3.2 Termination Due to Non-Payment by Licensee. If Licensee fails to make the payment specified in Section 3.1 above in the time specified, that failure will constitute a material breach of this Agreement. LML may then, after five business (5) days following written notice of such breach to Licensee, at its option, either terminate the Agreement or it may petition the Court for specific enforcement of Licensee's payment obligations. Licensee hereby consents to the jurisdiction of the Court for enforcement of the payment obligations in Section 3.1, and agrees that specific enforcement of the payment obligations of this Agreement is an available remedy.

3.3 Tax Liability. Each Party shall bear its own tax liability hereunder.

3.4 Additional Payments. The payment of the amount set forth in Section 3.1 shall be the total compensation to LML and any other LML Affiliates by Licensee for all releases, licenses, covenants and all other rights granted in this Agreement, and no additional payment shall be due or made to LML or any other person by Licensee with respect to the releases, licenses, covenants and all other rights granted in this Agreement.

3.5 Payment Transaction Forms. LML agrees that, as a condition to receiving payment as set forth herein, it shall complete RBS' standard W-9 form and ACH transmittal form.

*****This confidential portion has been omitted and filed separately with the Securities and Exchange Commission**

4. RELEASES AND COVENANT NOT TO SUE

4.1 LML's Release. Except for the obligations of Licensee under this Agreement and conditioned upon LML's receipt of payment from Licensee as specified under this Agreement, LML forever releases Licensee from any claims or causes of action for patent infringement, whether known or unknown, that as of the Effective Date, LML asserted or could have asserted.

4.2. Licensee's Release. Except for the obligations of LML under this Agreement, Licensee forever releases LML and its Affiliates from any claims or causes of action for patent infringement, whether known or unknown, that as of the Effective Date, Licensee asserted or could have asserted.

4.3 Covenant-Not-To-Sue. The Parties and their Affiliates covenant not to file suit against each other for infringement of any patents they own that are currently issued or that may hereafter issue on applications currently owned, or patents that they subsequently acquire that are not otherwise licensed under this Agreement. This covenant-not-to-sue will expire seven (7) years following the Effective Date of this Agreement.

5. GRANT OF LICENSE. LML hereby grants to Licensee a fully paid-up, irrevocable, non-exclusive, non-sublicensable, non-transferable license under the LML Patents to make, use, sell, offer for sale, import, and export the Licensed Products and Services. In addition, this grant of license applies to: (i) Customers, but only to the extent that such Customers purchase or receive Licensed Products and Services directly from the Licensee, and (ii) Third Party Converters, but only to the extent that such Third Party Converters create or process ACH Files directly for the Licensee and transmit those ACH Files to the Licensee for the purpose of further transmission to the ACH Network (as part of an ACH pass-through transaction) using the Licensed Products and Services. For the avoidance of doubt, this grant of license does not apply to (i) any ACH Files purchased or received by a Customer from any person or entity other than Licensee, or (ii) any ACH Files created or processed by a Third Party Converter for any person or entity other than Licensee. Except as expressly provided herein, nothing in the Agreement is intended to grant any rights or license, express or implied, to Licensee or exhaust any patent rights of LML with respect to the LML Patents.

6. CHANGE IN CONTROL/ACQUISITIONS

6.1 Acquisitions by Licensee. In the event Licensee acquires an entity after the Effective Date of this Agreement, such entity will not gain the benefit of the license grant, covenant-not-to-sue, or releases in the Agreement. LML agrees to negotiate in good faith with the acquired entity to license, under the LML Patents, any ACH Files created, processed, or transmitted by the acquired entity based on a presumptive royalty rate of $[***] U.S. dollars per ARC SEC-coded ECC transaction and $[***] U.S. dollars per POP, BOC, WEB, or TEL SEC-coded ECC transaction.

*****This confidential portion has been omitted and filed separately with the Securities and Exchange Commission**

6.2 Mergers Between Licensee and Another Entity.

(i) In the event Licensee merges with another entity that is not otherwise licensed under the LML Patents and the number of ACH Files created, processed, or transmitted by the merged entity each month after the date of the merger does not exceed [***]% of Licensee's average monthly transaction volumes for Licensed Products and Services (based on the 12 months preceding the date of the merger (hereinafter, "Conditional Merger Volume Limit"), then the license grant, covenant not to sue, and releases in this Agreement will continue to apply but only with respect to: (a) the Licensed Products and Services that existed prior to the date of the merger, and (b) the ACH Files created, processed or transmitted by the merged entity each month after the date of the merger up to the Conditional Merger Volume Limit.

(ii) In the event Licensee merges with another entity that is not otherwise licensed under the LML Patents and the number of ACH Files created, processed, or transmitted by the merged entity in any given month after the date of the merger exceeds the Conditional Merger Volume Limit (as defined above), then the provisions of Section 6.2(i) shall immediately terminate, and the license grant, covenant not to sue, and releases in this Agreement will continue to apply but only with respect to: (a) the Licensed Products and Services that existed prior to the date of the merger, and (b) the ACH Files created, processed or transmitted by the merged entity each month after the date of the merger up to [***]% of the Licensee's average monthly transaction volumes for Licensed Products and Services (based on the 12 months preceding the date of the merger) (hereinafter, "Adjusted Merger Volume Limit"). LML agrees to negotiate in good faith with the merged entity to license, under the LML Patents, any ACH Files created, processed, or transmitted by the merged entity in excess of the Adjusted Merger Volume Limit based on a presumptive royalty rate of $[***] U.S. dollars per ARC SEC-coded ECC transaction and $[***] U.S. dollars per POP, BOC, WEB, or TEL SEC-coded ECC transaction.

6.3 Acquisitions of Licensee.

(i) In the event of an acquisition of Licensee by an entity that is not otherwise licensed under the LML Patents and in which Licensee continues to exist as a legal entity and the number of ACH Files created, processed, or transmitted by the acquiring entity each month after the date of the acquisition does not exceed [***]% of Licensee's average monthly transaction volumes for Licensed Products and Services (based on the 12 months preceding the date of the acquisition (hereinafter, "Conditional Acquisition Volume Limit"), then the license grant, covenant not to sue, and releases in this Agreement will continue to apply but only with respect to: (a) the Licensed Products and Services that existed prior to the date of the acquisition, and (b) the ACH Files created, processed or transmitted by the acquiring entity each month after the date of the acquisition up to the Conditional Acquisition Volume Limit.

*****This confidential portion has been omitted and filed separately with the Securities and Exchange Commission**

(ii) In the event of an acquisition of Licensee by an entity that is not otherwise licensed under the LML Patents and in which Licensee continues to exist as a legal entity and the number of ACH Files created, processed, or transmitted by the acquiring entity each month after the date of the acquisition exceeds the Conditional Acquisition Volume Limit (as defined above), then the provisions of Section 6.3(i) shall immediately terminate, and the license grant, covenant not to sue, and releases in this Agreement will continue to apply but only with respect to: (a) the Licensed Products and Services that existed prior to the date of the acquisition, and (b) the ACH Files created, processed or transmitted by the acquiring entity each month after the date of the acquisition up to [***]% of the Licensee's average monthly transaction volumes for Licensed Products and Services (based on the 12 months preceding the date of the acquisition) (hereinafter, "Adjusted Acquisition Volume Limit"). LML agrees to negotiate in good faith with the acquiring entity to license, under the LML Patents, any ACH Files created, processed, or transmitted by the acquiring entity in excess of the Adjusted Acquisition Volume Limit based on a presumptive royalty rate of $[***] U.S. dollars per ARC SEC-coded ECC transaction and $[***] U.S. dollars per POP, BOC, WEB, or TEL SEC-coded ECC transaction.

6.4 Purchase of Assets of Licensee.

(i) In the event of a sale of the assets of Licensee that includes the business line that provides the Licensed Products and Services to an entity that is not otherwise licensed under the LML Patents and in which the number of ACH Files created, processed, or transmitted by the purchasing entity each month after the date of the purchase does not exceed [***]% of Licensee's average monthly transaction volumes for Licensed Products and Services (based on the 12 months preceding the date of the purchase (hereinafter, "Conditional Purchase Volume Limit"), then the license grant, covenant not to sue, and releases in this Agreement will continue to apply but only with respect to: (a) the Licensed Products and Services that existed prior to the date of the purchase, and (b) the ACH Files created, processed or transmitted by the purchasing entity each month after the date of the purchase up to the Conditional Purchase Volume Limit.

(ii) In the event of a sale of the assets of Licensee that includes the business line that provides the Licensed Products and Services to an entity that is not otherwise licensed under the LML Patents and in which the number of ACH Files created, processed, or transmitted by the purchasing entity each month after the date of the purchase exceeds the Conditional Purchase Volume Limit (as defined above), then the provisions of Section 6.4(i) shall immediately terminate, and the license grant, covenant not to sue, and releases in this Agreement will continue to apply but only with respect to: (a) the Licensed Products and Services that existed prior to the date of the purchase, and (b) the ACH Files created, processed or transmitted by the purchasing entity each month after the date of the purchase up to [***]% of the Licensee's average monthly transaction volumes for Licensed Products and Services (based on the 12 months preceding the date of the purchase) (hereinafter, "Adjusted Purchase Volume Limit").

*****This confidential portion has been omitted and filed separately with the Securities and Exchange Commission**

LML agrees to negotiate in good faith with the purchasing entity to license, under the LML Patents, any ACH Files created, processed, or transmitted by the purchasing entity in excess of the Adjusted Purchase Volume Limit based on a presumptive royalty rate of $[***] U.S. dollars per ARC SEC-coded ECC transaction and $[***] U.S. dollars per POP, BOC, WEB, or TEL SEC-coded ECC transaction.

6.5 Termination of Payments Due Pursuant to Section 6. With respect to any good faith negotiations undertaken pursuant to Sections 6.1 - 6.4 above, LML agrees that no royalty will be due under the LML Patents for any ACH Files created, processed, or transmitted by the Licensee or by any acquired entity, merged entity, acquiring entity, or purchasing entity (as described above) after the expiration date of the last to expire of the LML Patents.

7. CONFIDENTIALITY. The Parties may disclose the existence of this Agreement. Neither Party may disclose the specific terms and conditions of this Agreement to any entity except that each Party may disclose the terms and conditions of this Agreement: (i) to third parties with a need for access pursuant to the order or requirement of a court, administrative or regulatory agency, or other governmental body, provided that the Party required to make such a disclosure gives as much notice as is reasonably possible to the other Party to contest such order or requirement; (ii) on a confidential basis to its legal, accounting or financial advisors solely for the purposes of providing such advice and solely to the extent that they have a need for access; (iii) if that Party forms a good faith belief that disclosure is required under applicable securities regulations or listing agency requirements; (iv) in its financial statements as it is required to do under applicable generally accepted accounting principles while acting in reliance on its auditors; (v) to parties in the Lawsuits as part of disclosure obligations under the Court's Protective Order, (vi) upon the express written consent of the other Party; or (vii) on a confidential basis to investors and potential investors and acquirers, but subject to any such investor or potential investor or acquirer having first executed an appropriate non-disclosure agreement requiring such investor or potential investor or acquirer to maintain this Agreement and the terms and conditions of this Agreement in confidence.

8. REPRESENTATIONS AND WARRANTIES

8.1 Licensee Representations and Warranties. Licensee represents and warrants to LML that (a) it has all requisite legal right, power and authority to execute, deliver and perform this Agreement; and (b) it has the right to enter into this settlement and grant the releases, covenants not to sue and all other rights provided for under this Agreement without any payment to any other person or third Party.

*****This confidential portion has been omitted and filed separately with the Securities and Exchange Commission**

8.2 Licensor Representations and Warranties. As a condition precedent to Licensee entering into this Agreement, LML represents and warrants to Licensee that as of the Effective Date (a) it has all requisite legal right, power and authority to execute, deliver and perform this Agreement; (b) it has the right to enter into this Agreement and grant the licenses and covenants not to sue and all other rights provided for under this Agreement without any payment to any other person or third party; (c) it owns the LML Patents, and that no other person or third party owns any right to recover any amounts in connection with the LML Patents; (d) it has not granted and shall not grant any licenses or other rights, under the LML Patents or otherwise, that would conflict with or prevent the licenses and rights granted to Licensee hereunder; and (e) there are no liens, conveyances, mortgages, assignments, encumbrances, or other agreements that would prevent or impair the full and complete exercise of the terms and conditions of this Agreement.

9. GENERAL PROVISIONS

9.1 Assignment. This Agreement may not be assigned by either Party without the prior written consent of the other Party in its sole discretion. This Agreement shall inure to the benefit of, and shall bind, the respective heirs, executors, administrators, other legal representatives, successors and permitted assigns of the Parties hereto.

9.2 Entire Agreement. This Agreement and the License Agreement constitute the entire agreement between the Parties hereto with respect to the subject matter hereof and thereof and cancels and supersedes any prior understandings and agreements between the Parties hereto with respect thereto. There are no representations, warranties, terms, conditions, undertakings or collateral agreements, express, implied or statutory, between the Parties other than as expressly set forth in this Agreement.

9.3 Notices. All notices, requests, approvals, consents and other communications required or permitted under this Agreement will be in writing and addressed as follows:

<u>If to LML</u>:

Mr. Patrick H. Gaines
President
LML Patent Corp.
Suite 1680
1140 West Pender St.
Vancouver, BC V6E 4GI

<u>If to Licensee</u>:

RBS Citizens, N.A.
One Citizens Plaza
Providence, Rhode Island 02903
Mail Code RDC 360
Attention: Hollie Lussier

and will be deemed sufficiently given if delivered by hand or sent by certified mail (return receipt requested), courier, or facsimile (provided that the receiver acknowledges receipt of the facsimile) addressed to the other Party at the address set forth above or to such other person or address as the Parties may from time to time designate in writing delivered pursuant to this notice provision. Any such notices, requests, demands or other communications will be deemed to be delivered when received by the Party to whom they were addressed.

9.4 Governing Law. This Agreement is governed by and will be construed in accordance with the laws of the State of New York and the federal laws of the United States as applicable therein, without regard to the laws of those jurisdictions governing conflicts of laws.

9.5 Arbitration. All claims, disputes, or other differences between the Parties relating to or arising under this Agreement shall be exclusively resolved by binding arbitration pursuant to the Federal Arbitration Act and the Commercial Arbitration Rules of the American Arbitration Association ("AAA"), with arbitration to occur at a location to be determined by the three (3) arbitrators. The arbitration shall be before three (3) arbitrators. Each Party shall be entitled to select one (1) arbitrator, each of whom shall be an attorney with subject matter expertise in patent law and technology related to methods of electronically transferring funds, and the selected arbitrators shall together choose the third arbitrator, who shall also have the same required subject matter expertise. The arbitration proceedings and the documents, materials and testimony provided thereunder shall be kept confidential and the Parties and the arbitrators shall be required to execute a confidentiality agreement as necessary to protect the confidentiality of such documents, materials and testimony. Each Party shall bear its own attorneys' fees and costs in connection with the arbitration, including the costs of the AAA and the arbitrators, which shall be equally divided. The majority award of the arbitrators shall be final and binding on the Parties, and their successors and assigns. Each Party and its successors and assigns agrees to abide by any such award rendered in the arbitration, hereby consents to the jurisdiction of the Court for enforcement of any such award, and agrees that specific enforcement of any payment obligations pursuant to such an award is an available remedy.

9.6 Expenses. Except as otherwise specifically provided in this Agreement, the Parties agree that they shall bear their own costs and attorneys' fees incurred in connection with the negotiation and drafting of this Agreement and the transactions contemplated herein.

9.7 Headings. The section and sub-section headings contained in this Agreement are for convenience of reference only and shall not serve to limit, expand or interpret the sections or sub-sections to which they apply, and shall not be deemed to be a part of this Agreement.

9.8 Interpretation; Construction. The Parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if jointly drafted by the Parties and no presumption or burden of proof shall arise favoring or disfavoring either Party by virtue of the authorship of any provision of this Agreement.

9.9 Relationship of the Parties. This Agreement does not constitute and shall not be construed as constituting a partnership or joint venture between LML and Licensee, and neither Party shall have any right to obligate or bind the other Party in any manner whatsoever, and nothing herein contained shall give or is intended to give any rights of any kind to any third persons, except as expressly provided herein.

9.10 Enforceability. The Parties acknowledge and agree that this Agreement is enforceable according to its terms.

9.11 Severability. In the event that any term or provision of this Agreement is deemed invalid, unenforceable or void by a final, non-appealable judgment of a court of competent jurisdiction, the remainder of the Agreement shall be interpreted to the extent possible to effect the overall intention of the Parties as of the Effective Date of this Agreement.

9.12 Waiver of Section 1542 of the California Civil Code. The Parties to this Agreement hereby expressly waive the provisions of Section 1542 of the California Civil Code, which states as follows: "A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR."

9.13 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be considered one and the same document.

IN WITNESS WHEREOF, the Parties have caused this Agreement to be executed by their duly authorized officers as of the Effective Date.

LML PATENT CORPORATION

By: /s/ Patrick H. Gaines

Print Name: Patrick H. Gaines

Title: President

Dated: December 29, 2009

THE ROYAL BANK OF SCOTLAND PLC.

By: /s/ Denise M. Menelly

Print Name: Denise M. Menelly

Title: Executive Vice-President, COO Americas

Dated: December 29, 2009

Exhibit 31.1

RULE 13A-14(A) CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, Patrick H. Gaines, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of LML Payment Systems Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information, and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Patrick H. Gaines

Patrick H. Gaines
Chief Executive Officer
February 12, 2010

Exhibit 31.2

RULE 13A-14(A) CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Richard R. Schulz, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of LML Payment Systems Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information, and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Richard R. Schulz

Richard R. Schulz
Controller and Chief Accounting Officer
February 12, 2010

Exhibit 32.1

CERTIFICATION

I, Patrick H. Gaines, Chief Executive Officer of LML Payment Systems Inc. (the "Corporation") and I, Richard R. Schulz, Controller and Chief Accounting Officer of the Corporation, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that:

(1) The Quarterly Report on Form 10-Q of the Corporation for the three and nine month fiscal period ended December 31, 2009 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Corporation.

/s/ Patrick H. Gaines	/s/ Richard R. Schulz
Patrick H. Gaines	Richard R. Schulz
Chief Executive Officer	Controller and Chief Accounting Officer
February 12, 2010	February 12, 2010

A signed original of this written statement required by Section 906 has been provided to the Corporation and will be retained by the Corporation and furnished to the Securities and Exchange Commission or its staff upon request.