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BROADENGATE SYSTEMS INC  
Form 10QSB  
May 15, 2002

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2002  
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 1-12293

BROADENGATE SYSTEMS, INC.

-----  
(Exact name of small business issuer as specified in its charter)

Nevada

87-0394313

-----  
(State or Other Jurisdiction of  
Incorporation or Organization)

-----  
(I.R.S. Employer Identification No.)

3/F, Block 2, Cyber City, South Hi-tech Industrial Park,  
Shenzhen, Guangdong Province

-----  
(Address of Principal Executive Offices) (Zip Code)

011-86-755-671-6656

-----  
(Issuer's Telephone Number, including Area Code)

-----  
(Former Name, Former Address and Former Fiscal Year, if Changed  
Since Last Report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the past 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  No

As of May 13, 2002, 14,393,000 shares of our common stock, \$.001 par value were outstanding. As of such date, the aggregate market value of the common stock held by non-affiliates, based on the closing bid price on the NASD Bulletin Board, was approximately \$3,875,749.

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ESOFTBANK.COM, INC. and Subsidiaries

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

BROADENGATE SYSTEMS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2001 AND 2002  
(Unaudited)

2002

2002

2001

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	----- Rmb	----- Rmb	----- US\$
REVENUE	2,117,926	2,284,122	\$ 275,195
COST OF SALES	(1,443,985)	(1,689,807)	(203,591)
	-----	-----	-----
GROSS PROFIT (LOSS)	673,941	594,315	71,604
SELLING AND ADMINISTRATIVE EXPENSES	(2,818,282)	(1,974,563)	(237,899)
	-----	-----	-----
INCOME (LOSS) FROM OPERATIONS	(2,144,341)	(1,380,248)	(166,295)
OTHER INCOME (EXPENSE)			
INTEREST EXPENSE	(256,864)	(259,422)	(31,256)
DIVIDEND INCOME	-	493,753	59,488
OTHER INCOME, NET	161,535	11,060	1,333
	-----	-----	-----
TOTAL OTHER INCOME (EXPENSE), NET	(95,329)	245,391	29,565
	-----	-----	-----
INCOME (LOSS) BEFORE TAXES	(2,239,670)	(1,134,857)	(136,730)
INCOME TAXES	12,979	-	-
	-----	-----	-----
INCOME (LOSS) BEFORE MINORITY INTEREST	(2,252,649)	(1,134,857)	(136,730)
MINORITY INTEREST IN LOSS	(179,335)	-	-
	-----	-----	-----
NET INCOME (LOSS)	(2,431,984)	(1,134,857)	(136,730)
	=====	=====	=====
INCOME (LOSS) PER SHARE	(0.19)	(0.079)	\$ (0.0095)
	=====	=====	=====
WEIGHTED AVERAGE SHARES OUTSTANDING	12,920,000	14,393,000	14,393,000
	=====	=====	=====

The accompanying notes are an integral part of the consolidated financial statements.

BROADENGATE SYSTEMS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2001 AND MARCH 31, 2002  
(Unaudited)

	----- 2001 Rmb	----- 2002 Rmb	----- 2002 US\$
ASSETS			
CURRENT ASSETS			
Cash	7,995,053	142,107	\$ 17,121
Accounts receivable	3,192,662	4,144,842	499,379
Deposits and other	555,987	318,959	38,429

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Advances to employees	389,008	415,478	50,058
Costs and estimated earnings in excess of billings on uncompleted contracts	319,444	38,487	
	-----	-----	-----
TOTAL CURRENT ASSETS	12,132,710	5,340,830	643,474
	-----	-----	-----
NONCURRENT ASSETS			
Long-term investment	2,800,000	2,800,000	337,349
Fixed assets	2,432,328	2,360,968	284,454
Advances to employees	326,000	356,185	42,914
Intangibles	1,508,106	1,373,052	165,428
	-----	-----	-----
TOTAL NONCURRENT ASSETS	7,066,434	6,890,205	830,145
	-----	-----	-----
TOTAL ASSETS	19,199,144	12,231,035	1,473,619
	=====	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES			
Short-term borrowings-bank	24,000,000	16,000,000	\$1,927,711
Accounts payable	-	18,706	2,254
Accrued expenses			
Salaries, wages and other compensation	337,048	569,845	68,656
Employee fringe benefits	1,539,271	1,607,521	193,677
Taxes	17,458	50,147	6,042
Other	1,183,523	1,386,700	167,072
Customer deposits	15,000	38,327	4,618
Due to directors	4,163,531	4,091,039	492,896
Due to related parties	390,919	502,012	60,483
Due to employees	-	246,616	29,712
Billings in excess of costs and estimated earnings on uncompleted contracts	-	535,174	64,479
	-----	-----	-----
TOTAL CURRENT LIABILITIES	31,646,750	25,046,087	3,017,600
	-----	-----	-----
MINORITY INTEREST	-	-	-
	-----	-----	-----
SHAREHOLDERS' EQUITY (DEFICIT)			
Common stock, par value US\$0.001; issued and outstanding-14,393,000 shares as of December 31,2001 and March 31,2002	119,462	119,462	14,393
Additional paid-in capital	57,969,605	57,969,605	6,984,290
Subscription receivable	(767,411)	-	-
	-----	-----	-----
	-----	-----	-----
	-----	-----	-----
Reserve funds	347,148	347,148	41,825
Foreign currency translation		-	-
Accumulated deficit	(70,116,410)	(71,251,267)	(8,584,489)
	-----	-----	-----
	-----	-----	-----
TOTAL SHAREHOLDERS' EQUITY (DEFICIT)	(12,447,606)	(12,815,052)	(1,543,981)
	-----	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	19,199,144	12,231,035	1,473,619
	=====	=====	=====

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The accompanying notes are an integral part of the consolidated financial statements.

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BROADENGATE SYSTEMS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

THREE MONTHS ENDED MARCH 31, 2001 AND 2002  
(Unaudited)

	2001 Rmb	2002 Rmb	2002 US\$
	-----	-----	-----
Cash Flows from Operating Activities			
Net loss	(2,431,984)	1,134,857	(136,730)
	-----	-----	-----
Adjustments to reconcile net loss to net cash Used in operating activities:			
Depreciation	147,340	247,110	29,772
Amortization of product development costs	98,136	-	-
Amortization of Intangible assets	-	135,054	16,272
Provision for losses on receivables - Customers	265,089	-	-
Minority interest	179,335	-	-
(Increase) decrease in			
Accounts receivable	(1,265,554)	(1,140,580)	(137,419)
Deposits and other	353,710	67,028	8,076
Costs and estimated earnings in excess of billings on uncompleted contracts	(107,740)	(319,444)	(38,487)
Increase (decrease) in			
Accounts payable and accrued expenses	390,463	555,619	66,942
Customer deposits	(11,000)	23,327	2,811
Billings in excess of costs and estimated earnings on uncompleted contracts	258,122	535,174	64,478
	-----	-----	-----
Total Adjustments	307,901	103,288	12,445
	-----	-----	-----
Net Cash Used in Operating Activities	(2,124,083)	(1,031,569)	(124,285)
	-----	-----	-----
Cash Flows from Investing Activities			
Capital expenditures	(2,000)	(5,750)	(693)
Capitalized expenditures for product development costs	169,964	-	-
Advances to employees	(34,304)	(56,655)	(6,826)
Initial Investment of minority shareholder	95,352	-	-
	-----	-----	-----
Net Cash Used in Investing Activities	(301,620)	(62,405)	(7,519)
	-----	-----	-----
Cash Flows from Financing Activities			
Net borrowings from SiTech Holding	200,000	-	-
Net short-term borrowings	-	(8,000,000)	(963,855)
Net borrowings from director	571,373	-	-

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Proceeds from subscription receivable	-	767,411	92,459
Net borrowings from employees	-	246,616	29,712
Net borrowings from a director	-	115,908	13,965
Net borrowings from related parties	-	111,093	13,385
	-----	-----	-----
Net Cash Provided by (Used in) Financing Activities	771,393	(6,758,972)	(814,334)
	-----	-----	-----

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Net Decrease in Cash	(1,654,310)	(7,852,946)	(946,138)
Cash, Beginning of Period	3,221,718	7,995,053	963,259
	-----	-----	-----
Cash, End of Period	1,567,408	142,107	17,121
	=====	=====	=====

The accompanying notes are an integral part of the consolidated financial statements.

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BROADENGATE SYSTEMS, INC. AND SUBSIDIARIES  
Consolidated Statements of Shareholder's Equity  
Three Months Ended March 31, 2001 and 2002

	Common Stock		Additional Paid in Capital	Subscription Receivable	Retain Earni (Accumu Defic Rmb
	No. of Shares	Amount Rmb	Rmb	Rmb	Rmb
	-----	-----	-----	-----	-----
Balance as of January1, 2002	14,393,000	119,462	57,969,605	(767,411)	(70,116,
Net Loss					(1,134,
Proceeds from subscription receivable	14,393,000	119,462	57,969,605	767,411	(71,251,

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BROADENGATE SYSTEMS, INC. AND SUBSIDIARIES  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

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### NOTE 1 - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

The Company believes that the interim financial statements contain all adjustments necessary for a fair presentation of the results for such interim periods. All of these adjustments are normal recurring adjustments. The results of operations for interim periods do not necessarily predict the operating results for the full year. The consolidated balance sheet as of December 31, 2001 has been derived from audited financial statements but does not include all disclosures required by generally accepted accounting principles as permitted by interim reporting requirements. The information included in this report should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, the audited financial statements and related notes included in the Company's 2001 Form 10-KSB.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended December 31, 2001.

### NOTE 2 - ACQUISITIONS

On March 31, 2000, Natural Way Technologies, Inc. (Natural Way) entered into an Exchange agreement (the Exchange) with World Concept Development Limited (World), an independent third party. In accordance with the Exchange, Natural Way acquired 100% of the issued and outstanding shares of World in exchange for 9,300,000 post reverse split shares of Natural Way. Prior to closing, Natural Way effected a one for five reverse stock split and changed the name of the Company to ESFTBANK.COM, INC.

The Exchange has been accounted for using the purchase method of accounting as a reverse acquisition, whereby the company issuing its shares to effect the business combination is determined to be the acquirer in the business combination. This occurs when the shareholders of the issuer have less than a majority of voting control of the combined entity. The company whose shareholders retain the majority voting interest in the combined entity is presumed the acquirer. In the current Exchange, the existing shareholders of Natural Way will retain a 27% voting interest in the combined entity on completion of the Exchange. Accordingly, World is deemed to be the acquirer and the assets of Natural Way were required to be fair valued at acquisition. As Natural Way had no assets, as of the date of the Exchange, no fair value adjustment was required. The historical financial information prior to the Exchange are those of World.

World, a development stage enterprise, was incorporated on October 27, 1999, in the British Virgin Islands. World incorporated its wholly owned subsidiary ESFTBANK Networks (Shenzhen) Co. Ltd. (Shenzhen) on December 30, 1999, in the Peoples' Republic of China (PRC). World and Shenzhen were incorporated to effect a merger, exchange of capital stock, asset acquisition or other business combination with a domestic or foreign, private or publicly held business.

On February 21, 2000, World via Shenzhen, acquired 9.52% of the outstanding capital of SiTech, a company related through common ownership and management from Dr. Hongbing Lan, a director and stockholder of both World and SiTech for approximately \$62,650. On the same date, Shenzhen acquired an additional 42.86% of SiTech from SiTech Hainan Holding Co., Ltd. (Holdings), a company related

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through common ownership and management, for approximately \$280,000. Since both entities involved in the acquisition were under common control, the transaction was accounted for at historical cost in a manner similar to that in pooling-of-interests accounting. The cash consideration paid in these transactions was classified as a deemed dividend in the amount of Rmb 2,840,000. The consolidated financial statements include the results of operations for World and its subsidiaries from their inception.

On February 21, 2000, Shenzhen also acquired 80% of the newly issued and outstanding stock of Beijing, a PRC company, from Holdings for an initial capital investment of approximately \$116,000. The remaining 20% of Beijing is owned by Mr. Lan Hong Yu, the brother of Dr. Hongbing Lan.

During August of 2000, Shenzhen acquired a 2.67% interest for Rmb 2,800,000 in Xiangyou, a newly formed entity, whose primary stockholder and initiator is the Hunan Post Office (governmental agency). The new entity's development projects are to include: a postage computing system, telecommunication technology development, a postage machinery manufacturing line and other various technology related systems. The acquisition will be accounted for at the lower of cost or net realizable value.

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On October 14, 2001, Shenzhen acquired 70% of the outstanding capital of Dalian, an unrelated PRC company, in exchange for 307,000 shares of the Company valued at \$.55 per share or approximately \$168,675. Dalian is a software company in Northeastern China focusing on project management software and system integration. This acquisition was accounted for as a purchase in accordance with the SFAS No. 141, "Business Combinations."

### NOTE 3 - SHORT-TERM BORROWINGS-BANK

On May 29, 2000 the Company entered into a one-year credit facility with Shenzhen Commercial Bank for RMB 16 million at 5.3125%. The credit facility is secured by shares in the Company owned by Dr. Lan, director and shareholder of the Company.

On Aug. 25, 2001, the one-year credit facility was extended to Aug. 25, 2002 at 5.3125%.

### NOTE 4 - FOREIGN CURRENCY CONVERSION

The Company's financial information is presented in U.S. dollars. Reminbi, the functional currency of the Company has been converted into U.S. dollars at the exchange rate of 8.3 to 1.

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## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

### General

BroadenGate Systems, Inc. is a software outsourcing service provider operating in the People's Republic of China. The Company develops comprehensive outsourcing solutions for systems development and implementation projects and provides consulting services in the telecom, network security, e-Business, ERP, CRM EGIS sectors.

We believe that we are well positioned for growth in the developing information



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technology ("IT") industry in the PRC and internationally. With the PRC joining the WTO and the Beijing's 2008 Olympics, the IT outsourcing demand should increase during the next several years.

Since its inception in 1996, the company has grown with the Chinese domestic IT industry. BroadenGate is now leveraging its domestic expertise to enter the global outsourcing market, and to co-op with leading multinational software vendors in the Chinese market, such as Oracle and IBM. Building on the synergy between the Chinese and global markets, BroadenGate hopes to continue to increase its market share at home and win higher-margined contracts abroad.

### Recent Developments

The Company continues to increase its business base by forming close partnerships with some of the leading companies in the PRC, including Huawei Technology, which is among the largest manufacturers of telecommunications equipment in Asia. Our revenue mainly base on the four project management centers which were established last year. We are always trying to improve the management of the PMCS.

1. A Telecommunication & Internet Center: We have over 100 engineers currently working in this PMC, and have outstanding contracts for over 30 million RMB in 2002 with Huawei. We have reached an agreement of cooperation with the China Policy Security Bureau, to use our solutions in Internet access, network management and security, which should produce significant marketing potential in China. 2. A Development & International Center: We recently won a COBOL software development contract for approximately 15 million Yen (US\$1,150,000) in Dalian with SCM a subsidiary of Mitsubishi Corporation. 3. A Project Management Software & System Integration Center: This division is based on the Dalian Tongzhou Computer Software Co., Ltd. System (Tongzhou), and serves more than 1,000 clients in architectural, chemical, metallurgical, transportation, manufacturing and energy; 4. An E-Business and E-Banking Center: This center is new, but during the coming year, we anticipate building a local e-banking system in Hainan island.

Besides outsourcing services, we also develop software with ownership of intellectual rights, such as BroadenGate Network Checking System. We anticipate it will increase our revenues and lower the operating risk.

We will focus on the Chinese and Japanese markets this year. However, if the Company is to be a dominant player in the industry, it is critical to establish a physical presence in the US.

### RESULTS OF OPERATIONS

Revenues. Revenues increased by \$20,023 or 7.8% to \$275,195 for the three months ended March 31, 2002 from \$255,172 for the period ended March 31, 2001. This increase in revenues resulted from increased software outsourcing.

Cost of Sales. Cost of sales increased by \$29,617 or 17% to \$203,591 for the three months ended March 31, 2002 from \$173,974 for the same periods ended March 31, 2001. Cost of sales as a percent of revenues was 74% for the first quarter ended March 31, 2002 compared to 68% for the same periods ended March 31, 2001. This increase in cost of sales resulted from increased revenues and a change in the mix of products sold. The increase in cost of sales as a percentage of revenue is attributable to an increased percentage of sales from human resource outsourcing, which has a lower profit margin than software development.

Selling and Administrative Expenses. Selling and administrative expenses ("SGA")

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decreased by \$101,653 or 30% to \$237,899 for the first quarter ended March 31, 2002 from \$339,552 for the same periods ended March 31, 2001. This decrease in selling and administrative expenses resulted from decreased marketing expenses, decreased research and development expenses, and decreased professional expenses. We anticipate retaining a strict control over our expenditures. Our objective is to minimize SG&A expenditures without impairing our capacity to provide services.

Other income, Net. Other income, net consists of interest income and expense, bank charges, recovery of prior expenses, foreign exchange gains or losses, other miscellaneous income, and investment income. Other income, net totalled \$29,565 for the three months ended March 31, 2002, compared to other expenses, net totalled \$11,485 for the period ended March 31, 2001. This increase in other income, net resulted principally from investment income. The total amount of investment income was \$59,488 for the first quarter of 2002, compared to zero for the corresponding period of 2001. The increase resulted from the cash dividend distributed by Xiangyou.

Income Taxes. Income tax expense decreased by \$ 1,564 or 100% to zero for the three months ended March 31, 2002 from \$1,564 for the same periods ended March 31, 2001. Although the income of the Company increased, our company has been certificated as Hi-Tech company by local authority, and the government has refunded all taxes.

Minority Interest. Minority interest represents the 20% interest in eSoftBank (Beijing) Software Systems Co. Ltd., the 47.6% of SiTech Hainan Ltd. and 30% of Tongzhou (Dalian) Computer Co., Ltd., not owned by the Company.

As a result of the foregoing, the net loss decreased by \$156,280 or 53% to \$136,730 for the three months ended March 31, 2002 from \$293,010 for the period ended March 31, 2001. We believe that the foregoing trend will continue. As our revenues increase and expenses decrease, we expect that our operations as a software outsourcing services provider and subcontracting platform will result in smaller losses and, ultimately, profitability. Notwithstanding our expectations, however, there is no assurance that we will ever become profitable.

### Liquidity and Capital Resources

As of March 31, 2002, we had cash of \$17,121 and a deficit in working capital of \$2,374,126. This compares with cash of \$188,845 and negative working capital of \$2,206,250 as of March 31, 2001. Our cash decreased because of a refund of borrowings and a net loss. However, our working capital deficit is principally the result of our net operating losses.

Cash used in operating activities totaled \$124,285 for the three months ended March 31, 2002. This compares with cash used in operating activities of \$260,046 for the period ended March 31, 2001. The change in cash flows from operating activities principally resulted from a reduced net operating loss for current period.

Cash used in investing activities totaled \$7,519 for the three months ended March 31, 2002, compared to cash used in investing activities of \$32,207 for the period ended March 31, 2001. This change mainly resulted from no capitalized expenditures for product development costs and no other fixed assets expenditures in the current period.

Cash used in financing activities totaled \$814,334 for the three months ended March 31, 2002. This compares with cash provided by financing activities of \$92,939 for the period ended March 31, 2001. The net change is attributable to reduced borrowings in the current period and no loan repayments in the current period.

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For the three months ended March 31, 2002, we have no plans for any major capital expenditures.

Based on our current level of cash, the deficit in working capital and current level of expenditures in our business, it will be necessary to seek additional sources of funding over the next twelve months. Management is negotiating with its banks for more project finance to fund operations for the current year. However, without outside financing or the sale of stock the Company has insufficient resources to continue its business operation for the next twelve months. No assurance can be given that the Company will be able to obtain any financing or sell any of its shares.

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### PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

None

Item 2. Changes in Securities and Use of Proceeds.

None

Items 3 - 5. We have nothing to report under these items.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits - None.

(b) Reports on Form 8-K - None.

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### SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Broadengate Systems, Inc.

By: /s/ Dr. Hongbing Lan

-----  
Dr. Hongbing Lan  
Chief Executive Officer

By: /s/ Hongyu Lan

-----  
Lan Hongyu  
Principal Accounting Officer

Dated: May 12, 2002

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In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name -----	Title -----	Date -----
/s/ Hongbing Lan -----	Chairman, Chief Executive Officer	May 12, 2002
Dr. Hongbing Lan		
/s/ Xinmin Gao -----	Director	May 12, 2002
Mr. Xinmin Gao		
/s/ Fa Ding Liu -----	Director	May 12, 2002
Mr. Fa Ding Liu		