PACIFICNET INC
Form 10-Q
November 27, 2007

U.S. 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 SEPTEMBER 30, 2007

[ ] 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: 000-24985

PACIFICNET INC.
(Exact name of registrant in its charter)

Delaware	**91-2118007**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
23/F, TOWER A, TIMECOURT, NO.6 SHUGUANG XILI, CHAOYANG DISTRICT, BEIJING, CHINA 100028	n/a
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: 0086-10-59225000

Indicate by check mark whether the registrant (1) has filed all reports required 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 o NO þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large Accelerated Filer o Accelerated Filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO þ

As of October 31, 2007, there were 11,984,072 shares of the issuer’s common stock, par value $0.0001 per share, outstanding.

PACIFICNET INC.

Form 10-Q for the Quarterly Period Ended September 30, 2007

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands of United States dollars, except par values and share numbers)

	September 30, 2007 (Unaudited)	December 31, 2006 (Audited) Restated
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,889	$ 1,900
Restricted cash - pledged bank deposit	239	234
Accounts receivables	6,665	8,141
Inventories	553	201
Loan receivable from related parties	2,227	1,706
Loan receivable from third parties	2,260	128
Marketable equity securities - available for sale	1,059	558
Loans to employees	1,884	770
Other receivables, net	2,900	170
Other current assets	6,659	3,233
Total Current Assets	29,335	17,041
Property and equipment, net	5,794	4,711
Investments in affiliated companies and subsidiaries	353	1,257
Intangible assets, net	337	323
Goodwill	6,258	5,601
Other assets	76	471
Net assets held for disposition	810	7,522
TOTAL ASSETS	42,963	36,926
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Bank line of Credit	$ 181	$ 855
Bank loans-current portion	768	576
Capital lease obligations - current portion	90	120
Accounts payable	2,166	1,266
Accrued expenses and other payables	2,950	1,828
Customer deposits	430	352
Loans payable to related party	681	638
Convertible debenture	6,218	8,945
Warrant liability	761	904
Liquidated damages liability	2,697	2,837
Total Current Liabilities	16,942	18,321
Long-term liabilities:		
Bank loans - non current portion	2,051	1,635
Capital lease obligations - non current portion	62	124
Convertible Debenture- non current portion	4,908	-

Total long-term liabilities	7,021	1,759
Total liabilities	23,963	20,080
Minority interest in consolidated subsidiaries	4,032	2,869
Commitments and contingencies		
Stockholders' Equity:		
Preferred stock, par value $0.0001, Authorized 5,000,000 shares		
Issued and outstanding - none		
Common stock, par value $0.0001, Authorized 125,000,000 shares;		
Issued and outstanding:		
September 30, 2007: 14,557,041 shares issued, 11,984,072 outstanding		
December 31, 2006: 14,155,597 issued, 11,538,664 outstanding	1	1
Treasury stock, at cost (2007 Q3: 2,572,969 shares, 2006: 2,616,933 shares)	(145)	(272)
Additional paid-in capital	67,409	65,757
Cumulative other comprehensive income (loss)	(84)	(42)
Accumulated deficit	(51,729)	(51,090)
Less: stock subscription receivable	(484)	(377)
Total Stockholders' Equity	14,968	13,977
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 42,963	$ 36,926

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

3

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited. In thousands of United States dollars, except loss per share and share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2007 Unaudited	**2006 Unaudited Restated**	**2007 Unaudited**	**2006 Unaudited Restated**
Net Revenues	$	$	$	$
Services	4,497	3,938	13,361	11,420
Product sales	5,305	6,587	14,729	20,912
Total Net Revenues	9,802	10,525	28,090	32,332
Cost of revenues				
Services	3,441	3,076	9,626	8,203
Product sales	3,987	6,342	11,190	19,507
Total Cost of Revenues	7,428	9,418	20,816	27,710
Gross Profit	2,374	1,107	7,274	4,622
Selling, general and administrative expenses	2,030	1,580	5,395	4,067
Provision for doubtful accounts		312		310
Depreciation and amortization	207	145	595	303
Total Operating Expenses	2,237	1,725	5,990	4,370
INCOME(LOSS) FROM OPERATIONS	137	(618)	1,284	252
Other Income(Expenses):				
Interest income Expenses), net	(223)	(252)	(655)	(649)
Gains(Loss) in change in fair value of derivatives	62	1,004	143	1,212
Liquidated damages expense	-	(800)	-	(800)
Sundry income, net	245	9	291	77
Total Other Income (Expenses)	84	(39)	(221)	(160)
Income(Loss) before Income Taxes and Minority Interest	221	(657)	1,063	92
Provision for income taxes	46	(40)	-	(70)
Share of earnings of associated companies	(23)	80	(23)	129
Minority interests	(130)	(12)	(1,004)	(527)
Income(Loss) from Continued Operations	114	(629)	36	(376)
Loss on disposal	(356)	-	(925)	-
Income from discontinued operations	22	(486)	250	980
Total discontinued operations income (loss)	(334)	(486)	(675)	980
Net Income (Loss)	(220)	(1,115)	(639)	604
Unrealized gain on marketable securities	114	-	114	-
Foreign exchange gain (loss)	(38)	-	(135)	-
Net Comprehensive Loss	$ (144)	$ (1,115)	$ (660)	$ 604

Basic Earnings (Loss) per share-Continued Operations	$	0.01	$	(0.05)	$	0.00	$	(0.03)
Basic Earnings (Loss) per share-Discontinued Operations	$	(0.03)	$	(0.04)	$	(0.06)	$	0.05
Basic Earnings (Loss) per share	$	(0.02)	$	(0.09)	$	(0.06)	$	0.02
Diluted Earnings (Loss) per share-Continued Operations	$	0.01	$	(0.05)	$	0.00	$	(0.03)
Diluted Earnings (Loss) per share-Discontinued Operations	$	(0.03)	$	(0.04)	$	(0.06)	$	0.05
Diluted Earnings (Loss) per share	$	(0.02)	$	(0.09)	$	(0.06)	$	0.02
Weighted average number of shares-Basic		11,931,094		11,619,010		11,805,686		11,171,608
Weighted average number of shares-Diluted		12,027,315		11,619,010		11,858,870		11,171,608

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

4

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited. In thousands of United States dollars, except earnings per share and share amounts)

	For the Nine Month Periods Ended September 30,	
	2005 (Unaudited)	**2006 (Unaudited) (Restated)**
Cash Flows from operating activities		
Net income (loss)	$ (639)	$ 604
Adjustment to reconcile net income/(loss) to net cash provided by (used in) operating activities:		
Equity earnings of associated companies	23	(129)
Provision for allowance for doubtful accounts	1,391	310
Minority Interest	1,004	527
Depreciation and amortization	595	303
Stock-based compensation	-	120
Change in fair value of derivatives	(143)	(1,212)
Amortization of interest discount	-	307
Liquidated damages expense	-	800
Changes in current assets and liabilities net of effects from purchase of subsidiaries:		
Accounts receivable and other current assets	(5,794)	(2,753)
Inventories	(352)	(119)
Accounts payable and other accrued expenses	945	(1,528)
Loans receivable from third parties	(2,132)	(1,091)
Net cash used in operating activities of continued operations	(5,102)	(3,861)
Net cash used in operating activities of discontinued operations	6,712	(8,283)
Net cash provided by (used in) operating activities	**1,610**	**(12,144)**
Cash flows from investing activities		
(Increase) / Decrease in restricted cash	(5)	2
Increase in purchase of marketable securities	(501)	13
Acquisition of property and equipment	(828)	(1,713)
Acquisition of subsidiaries and affiliated companies	-	(419)
Net cash used in investing activities of continued operations	(1,334)	(2,117)
Net cash used in investing activities of discontinued operations	925	-
Net cash used in investing activities	(409)	(2,117)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Loan payable to related party	43	(265)
Loans receivable from related party	(521)	(889)
Advances (repayments) under bank line of credit	(674)	22
Advances (repayments) of bank loans	608	1,152
Increase (repayments) of amount borrowed under capital lease obligations	(92)	77
Sale (Repurchase) of treasury shares	127	(124)
Proceeds from exercise of stock options and warrants	96	174
Repayment of convertible debenture	(3,672)	-
Net proceeds from issuance of convertible debenture	5,853	7,500
Net cash provided by financing activities of continued operations	1,768	7,647

Net cash provided by financing activities of discontinued operations		-		-
Net cash provided by financing activities		1,768		7,647
Effect of exchange rate change on cash and cash equivalents		20		282
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		2,989		(6,332)
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD		1,900		9,579
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	$	4,889	$	3,247
CASH PAID FOR:				
Interest	$	385	$	744
Income taxes	$	-	$	502
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Fixed assets acquired under banking loan	$	-	$	1,082
Options exercised for shares receivable	$	484	$	434
Investments in subsidiaries acquired through the issuance of common stock	$	-	$	3,578
Redemption of convertible debenture	$	1,091	$	-

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

PACIFICNET INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Amounts expressed in United States dollars unless otherwise stated)

1. BASIS OF PRESENTATION

Description of Operations - PacificNet Inc. (referred to herein as "PacificNet" or the "Company") is a leading provider of gaming technology, e-commerce, and Customer Relationship Management (CRM) in China. Our gaming products are specially designed for the Chinese and Asian gamers, and we focus on integrating localized Chinese and Asian themes and content, advanced graphics, digital sound effects and popular domestic music, with secondary bonus games and jackpots. Our gaming products include: Multi-player Electronic Table Games - Baccarat, Sicbo, Fish-Prawn-Crab, and Roulette machines, server based games (SBG) with multiple client betting stations, slot and bingo machines, video lottery terminals (VLTs), amusement with prices (AWP) machines, gaming cabinet and client/server system designs, online i-gaming software design, and multimedia entertainment kiosks. PacificNet's gaming clients include the leading hotels, casinos, and gaming operators in Macau, Asia, and Europe, and our ecommerce and CRM clients include the leading telecom companies, banks, insurance, travel, marketing and business services companies and telecom consumers in Greater China such as China Telecom, China Mobile, Unicom, PCCW, Hutchison Telecom, Bell24, Motorola, Nokia, SONY, TCL, Huawei, American Express, Citibank, HSBC, Bank of China, Bank of East Asia, DBS, TNT, China and Hong Kong government. PacificNet employs about 1,200 staff in its various subsidiaries throughout China with offices in Hong Kong, Beijing, Shanghai, Shenzhen, Guangzhou, Macau and Zhuhai China, in the USA, and in the Philippines.

Consolidated Interim Financial Statements - The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial reporting consistent in all material respects with those applied in the Company’s Annual Report on Form 10-K, as amended, for the year ended December 31, 2006, but do not include all disclosures required by GAAP. You should read these interim consolidated financial statements in conjunction with the audited financial statements, including the notes thereto, and the other information set forth in the Company’s Annual Report on Form 10-K, as amended, for the year ended December 31, 2006. The unaudited consolidated financial statements include the accounts of PacificNet Inc. and its subsidiaries and variable interest entities (“VIEs”) for which the Company is the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all material adjustments considered necessary for a fair presentation of the Company’s interim results have been reflected. PacificNet’s 2006 Annual Report on Form 10-K includes certain definitions and a summary of significant accounting policies and should be read in conjunction with this report. The results for interim periods are not necessarily indicative of annual results.

Use of Estimates - The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, and such differences may be material to the financial statements. Certain prior year amounts have been reclassified to conform to the current year presentation.

Reclassification - Certain items in the accompanied consolidated financial statements have been re-classed for comparative purposes.

Going Concern

As shown in the accompanying consolidated financial statements, the Company incurred accumulated losses of $52 million and $51.1 million as of September 30, 2007 and December 31, 2006, respectively. These matters raise substantial doubt about the Company's ability to continue as a going concern.

In view of the matters described in the preceding paragraph, recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon continued operations of the Company, which in turn is dependent upon the Company's ability to raise additional capital, obtain financing and to succeed in its future operations. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

The Company has taken certain restructuring steps to provide the necessary capital to continue its operations. These steps included, but were not limited to: 1) accelerate disposal and spin-off of unprofitable or unfavorable return-on-investment non-gaming operations; 2) focus on execution of the new high potential gaming business initiatives; 3) acquisition of profitable and/or strategic operations through issuance of equity instruments; 4) formation of strategic relationship with key gaming operators in Asia; and 5) issuance and/or restructure of new long-term convertible debentures.

On April 30, 2007, the Company entered into a sale and purchase agreement to dispose of its interest in Guangzhou3G for a consideration of US$6 million. The deal was subsequently reopened for renegotiation in November 2007 (See note 12).

On May 15 & 20, 2007, the Company entered into various definitive agreements to reduce its equity interests in certain unprofitable subsidiaries to 15%, namely: Linkhead, Clickcom, PacTelso, PacSo and PacPower (See note 12).

2. RECENT ACCOUNTING PRONOUNCEMENTS

In March 2007, the Emerging Issues Task Force (“EITF”) reached a consensus on issue number 06-10, “Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements,” (“EITF 06-10”). EITF 06-10 provides guidance to help companies determine whether a liability for the postretirement benefit associated with a collateral assignment split-dollar life insurance arrangement should be recorded in accordance with either SFAS No. 106, “Employers’ Accounting for Postretirement Benefits Other Than Pensions” (if, in substance, a postretirement benefit plan exists), or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract). EITF 06-10 also provides guidance on how a company should recognize and measure the asset in a collateral assignment split-dollar life insurance contract. EITF 06-10 is effective for fiscal years beginning after December 15, 2007, though early adoption is permitted. The management is currently evaluating the effect of this pronouncement on financial statements.

In February 2007, FASB issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. FAS 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted subject to specific requirements outlined in the new Statement. Therefore, calendar-year companies may be able to adopt FAS 159 for their third quarter 2007 financial statements.

The new Statement allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. FAS 159 also establishes presentation and disclosure requirements designed to draw comparison between entities that elect different measurement attributes for similar assets and liabilities. The management is currently evaluating the effect of this pronouncement on financial statements.

In September 2006, FASB issued SFAS 158 ‘Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)’ This Statement improves financial reporting by requiring an employer to recognize the over funded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. The requirement to measure plan assets and benefit obligations as of the date of the employer’s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company currently does not have any defined benefit plan and so FAS 158 will not affect the financial statements.

In September 2006, FASB issued SFAS 157 ‘Fair Value Measurements’. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The management is currently evaluating the effect of this pronouncement on financial statements.

3. EARNINGS PER SHARE

Basic and diluted earnings or loss per share (EPS) amounts in the financial statements are computed in accordance with SFAS No. 128, "Earnings Per Share." Basic EPS is based on the weighted average number of common shares outstanding. Diluted EPS is based on the weighted average number of common shares outstanding plus dilutive common stock equivalents. Basic EPS is computed by dividing net income/loss available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period Diluted EPS is calculated by dividing net earnings by the weighted average number of common shares outstanding and other dilutive securities. Dilutive earnings per share for the period ended September 30, 2007 exclude the potential dilutive effect of 889,456 warrants because their impact would be anti-dilutive based on current market prices. 472,728 convertible debentures are tested by using if-converted method. The result shows when convertible debentures are included in the computation, diluted EPS increases. According to SFAS No.128, those convertible debentures are ignored in the computation of diluted EPS. All per share and per share information are adjusted retroactively to reflect stock splits and changes in par value.

The reconciliation of the numerators and denominators of the basic and diluted EPS calculations was as follows:

(IN THOUSANDS OF UNITED STATES DOLLARS, EXCEPT WEIGHTED SHARES AND PER SHARE AMOUNTS)	**Three Months Ended September 30**		**Nine Months Ended September 30**	
	2007	**2006**	**2007**	**2006**
Numerator: Net Income (Loss)	$ (220)	$ (1,115)	$ (639)	$ 604
Denominator:				
Weighted-average shares used to compute basic EPS	11,931,094	11,619,010	11,805,686	11,171,608
Weighted-average shares used to compute diluted EPS	12,027,315	11,619,010	11,858,870	11,171,608
Basic earnings (loss) per common share:	$ (0.02)	$ (0.09)	$ (0.06)	$ 0.02
Diluted earnings (loss) per common share:	$ (0.02)	$ (0.09)	$ (0.06)	$ 0.02

4. OTHER CURRENT ASSETS

Other current assets consist of the following at September 30, 2007 (in thousands):

Other current assets	**September 30, 2007 Unaudited**	**December 31, 2006 Audited Restated**
Prepayment	$ 832	$ 1,048
Utilities deposit	396	1,292
Receivable from Lion Zone Holdings Ltd & HeySpace [1]	5,260	485
Prepaid expenses	171	408
Total	$ 6,659	$ 3,233

(1) As of September 30, 2007 receivable from Lion Zone is $132,000 and From HeySpace is $5,128,000

5. GOODWILL AND BUSINESS ACQUISITIONS

The changes in the carrying amount of goodwill for the following reporting periods are summarized below:

(US$000s)	Group 1. Outsourcing Services	Group 2. Telecom Value-Added Services	Group 3. Products (Gaming and Technology)	Total (Unaudited)
Balance as of December 31, 2006	$3,964	$461	$1,176	$5,601
Goodwill acquired during the first quarter	-	-	657	657
Balance as of September 30, 2007	$3,964	$461	$1,833	$6,258

The Company acquired additional 31% interest in Take 1 Technology Ltd on January 5, 2007 and recorded additional goodwill amounting to $657,000. Prior to acquisition of additional interest, the Company owned 20% interest in Take 1 Technology Ltd (See note 13).

6. ACCRUED EXPENSES & OTHER PAYABLES

Accrued expenses and other payables comprises of the following as of September 30, 2007 and December 31, 2006.

(in thousands of US Dollars):	2007 Unaudited	2006 Audited Restated
Professional fee	$ 1,534	$ 321
Director fee	233	100
Salaries and benefit payable	281	792
Marketing expense	838	389
Income tax payable	7	-
Others	57	226
Total	$ 2,950	$ 1,828

7. STOCKHOLDERS' EQUITY

a) COMMON STOCK

For the nine months period ended September 30, 2007, the Company had the following equity transactions: (i) 199,444 shares of common stock were issued as the monthly principal redemption shares for 8 million convertible debentures from January to March, such shares are valued at $1,090,914; (ii) 41,426 treasury shares were sold to the open market with total consideration $127,000; (iii) 202,000 shares as a results of exercise of stock options with cash consideration of $406,000. As of September 30, 2007, the Company received $196,000 from exercise of stock options.

b) STOCK OPTION PLAN

Prior to January 1, 2006, PacificNet accounted for awards granted under stock-based compensation plans following the recognition and measurement principles of APB 25, *Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, compensation expense was recognized for awards granted at an exercise price less than fair market value of the underlying common stock on the date of grant. Effective January 1, 2006, PacificNet adopted the fair value recognition provisions of SFAS 123(R). See Note 2 for a description of the Company’s adoption of SFAS 123R. The fair value of stock options is determined using the Black-Scholes option pricing model, which is consistent with the valuation techniques previously utilized for options in footnote disclosures required under SFAS 123, as amended by FASB Statement No. 148, “Accounting for Stock-Based Compensation - Transition and Disclosure.” The determination of the fair value of stock-based compensation awards on the date of grant using an option-pricing model is affected by the Company’s stock price as well as assumptions regarding a number of complex and subjective variables, including the expected volatility of the Company’s stock price over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The valuation provisions of SFAS 123(R) apply to new grants and unvested grants that were outstanding as of the effective date. For the nine months ended September 30, 2007, no new options were granted and no options were vested, thus the compensation costs is zero. PacificNet elected the modified prospective method and therefore has not restated results for prior periods due to 123R.

The status of the Stock Option Plan as of September 30, 2007, is as follows:

	OPTIONS OUTSTANDING		WEIGHTED AVERAGE EXERCISE PRICE
OUTSTANDING, DECEMBER 31, 2006	370,500	$	2.00
Granted	--		-
Cancelled	-		-
Exercised	-		-
OUTSTANDING, MARCH 31, 2007	370,500	$	2.00
Granted	-		-
Cancelled	-		-
Exercised	-		-
OUTSTANDING, JUNE 30, 2007	370,500	$	2.00
Granted	788,000	$	4.31
Cancelled	168,500	$	2.00
Expired without exercising	68,500	$	2.00
Exercised	202,000		$2.00
OUTSTANDING, SEPTEMBER 30, 2007	**788,000**		**$4.31**

9

Following is a summary of the status of options outstanding at September 30, 2007:

Grant Date	Total Options Outstanding	Aggregate Intrinsic Value	Weighted Average Remaining Life (Years)	Total Weighted Average Exercise Price	Option Exercisable	Weighted Average Exercise Price
2007-8-13	788,000	$441,280	5.86	$4.31	-	$4.31

The 788,000 outstanding options, which were granted on August 11, 2007, will be vested from August 8, 2008 with a 5% per quarter vesting schedule, and the corresponding compensation costs will be recorded within the vesting period. The weighted-average fair value of such options was $2.75.The assumptions used in calculating the fair value of options granted using the Black-Scholes option- pricing model are as follows:

Risk-free interest rate	4.51%
Expected life of the options	5.86 years
Expected volatility	67.44%
Expected dividend yield	0%

788,000 options were granted and 202,000 were exercised during the nine month period ended September 30, 2007. No options were vested during the nine month period ended September 30, 2007.

c) WARRANTS

At September 30, 2007, the Company had outstanding and exercisable warrants to purchase an aggregate of 1,007,138 shares of common stock. The weighted average remaining life is 2.59 years and the weighted average exercise price per share is $10.61 per share.

Following is a summary of the warrant activity:

	Warrants outstanding	WEIGHTED AVERAGE EXERCISE PRICE	Aggregate Intrinsic Value
OUTSTANDING, DECEMBER 31, 2005	**591,138**	$ 9.5	$ -
Granted	416,000	-	
Forfeited	-	-	
Exercised	-	-	
OUTSTANDING, DECEMBER 31, 2006	**1,007,138**	$ 10.61	$ -
Granted	**-**	**-**	
Forfeited	**-**	**-**	
Exercised	**-**	**-**	
OUTSTANDING, MARCH 31, 2007	**1,007,138**	$ 10.61	**$ -**
Granted	**-**	**-**	
Forfeited	**-**	**-**	
Exercised	**-**	**-**	
OUTSTANDING, JUNE 30, 2007	**1,007,138**	$ 10.61	$ -
Granted	**-**	**-**	
Forfeited	**-**	**-**	
Exercised	**-**	**-**	

OUTSTANDING, SEPTEMBER 30, 2007	**1,007,138**	$	10.61	$	-

Following is a summary of the status of warrants outstanding at September 30, 2007:

Grant Date	Total warrants Outstanding	Weighted Average Remaining Life (Years)	Total Weighted Average Exercise Price	Warrants Exercisable	Weighted Average Exercise Price
2004-1-15	123,456	1.29	$7.15	123,456	$7.15
2004-11-15	117,682	2.13	$3.89	117,682	$3.89
2004-12-9	350,000	2.19	$12.21	350,000	$12.21
2006-3-13	416,000	3.45	$12.20	416,000	$12.20

On March 13, 2006, we issued 400,000 warrants to several institutional investors in connection with a private placement of $8 million in convertible debentures. On the same day we issued another 16,000 warrants to our placement agent for the transaction. Those warrants have a term of 5 years and immediately vesting. The assumptions used in calculating the fair value of such warrants granted using the Black-Scholes option- pricing model are as follows:

Risk-free interest rate	4.78%
Expected life of the options	5.00 years
Expected volatility	37.08%
Expected dividend yield	0%

No warrants were granted, cancelled and exercised during the nine months period ended September 30, 2007.

d) TREASURY STOCK

The following is a summary of the movement of the Company's shares held as treasury stock for the quarterly ended September 30 of 2007:

	Number of shares	Mark
Escrow shares returned to treasury on	800,000	
Repurchase in the open market	40,888	
Repurchase of shares from Take1	149,459	
Cancellation of former employee shares	45,000	
Holdback shares as contingent consideration due to performance targets not yet met	529,848	(1)
Termination with ChinaGoHi	825,000	
Incomplete acquisition of Allink	200,000	
Repurchase of shares from Yueshen	24,200	
Shares sold to the open market	(41,426)	
Balance, September 30, 2007	2,572,969	
Shares outstanding at September 30, 2007	11,984,072	
Shares issued at September 30, 2007	14,557,041	

(1) Includes shares related to Clickcom 78,000, Guangzhou (Wanrong) 138,348, IMobile 153,500 and Games 160,000

From January 24, 2007 to January 30, 2007, we sold 41,426 treasury shares to the open market for total consideration of $127,000.

8. CONVERTIBLE DEBENTURES

8.1 Eight Million Convertible Debentures

On March 13, 2006, we completed a private placement in which we sold $8,000,000 in convertible debentures and issued warrants to purchase up to an aggregate of 400,000 shares of common stock. The debentures are convertible at any time into shares of our common stock at an initial fixed conversion price of $10.00 per share, subject to adjustments for certain dilutive events. The debentures are due March 13, 2009. The warrants are exercisable for a period of five years at an exercise price of $12.20 per share. At the closing of the private placement, we prepaid the first year's interest on debentures equal to 5% of the aggregate principal amount of debentures. We will pay interest in cash or shares, provided that certain conditions are met, at the rate of 6% for the second year the debentures are outstanding and then 7% for the third. Beginning January 1, 2007, we are obligated to redeem up to $320,000 every month, plus accrued, but unpaid interest, liquidated damages and penalties. We also have the option to prepay the debentures at any time, provided that certain conditions have been met, after the 12 month anniversary of the effective date of the registration statement that has been filed with the Securities and Exchange Commission with respect to the common stock issuable upon conversion of the debentures, some or all of the outstanding debentures for cash in an amount equal to 120% of the principal amount outstanding, plus accrued, but unpaid interest, liquidated damages and penalties outstanding. At any time after the nine months anniversary of the effective date of the registration statement, we may force the holders to convert up to 50% of the then outstanding principal amount of the debentures, subject to certain trading conditions being met. If any event of default occurs under the debentures or other related documents, the holders may elect to accelerate the payment of the outstanding principal amount of the debenture, plus accrued, but unpaid interest, liquidated damages and penalties, which shall become immediately due and payable.

Under the terms of a registration rights agreement entered into at the time of the private placement, the Company was obligated to file a registration statement with respect to the shares issuable under the debenture and the warrants by April 30, 2006, and have the registration statement declared effective by the SEC no later than June 28, 2006. Due to various factors, the Company did not file the registration statement until May 15, 2006, and it was not declared effective until December 8, 2006. Therefore, under the terms of the registration rights agreement, the Company was obligated to pay liquidated damages to the investors at the rate of 2% of the principal amount of the debenture each month beginning on June 28, 2006 until the effectiveness of the registration statement, which was equal to $1,120,000, in the aggregate.

In February 2007, upon reaching an agreement on the amount and payment of accrued liquidated damages, the Company signed a Settlement and Release Agreement with each of the investors. Under the terms of the Settlement and Release Agreements, the Company paid an aggregate $140,000 in cash as satisfaction in full of liquidated damages owed to Basso Fund Ltd., Basso Multi-Strategy Holding Fund Ltd., and Basso Private Opportunities Holding Fund Ltd. Partial liquidated damages owed to Whalehaven Capital Fund Ltd. were paid in the amount of $35,000 in cash, with the remaining liquidated damages in the amount of $105,000 paid in the form of a new convertible debenture due February 2009, on substantially the same terms as the original debentures, except that interest only is paid on the new debentures until October 2008 and beginning in November 2008 until February 2009, when the new debentures are due, the monthly redemption amount under the new debentures shall be equal to $315,000. The remaining investors also agreed to accept the aggregate $840,000 in liquidated damages owed to them in the form of the new convertible debentures for the amount of their respective portion of the liquidated damages. The Company also agreed to amend the original debentures to shorten the term for payment of the original principal amount to a 22 month term. As a result the monthly redemption amount for the original debenture increased from $320,000 to $ 363,638. All other terms and conditions of the original debenture remain in full force and effect. The outstanding original principal amount as at September 30, 2007 is $6,217,718.

C.E. Unterberg, Towbin L.L.C. acted as placement agent and received a negotiated cash fee in the amount of $449,500 and a warrant to purchase up to 16,000 shares at an exercise price of $12.20 per share, which expire five years from the date of issuance. The fair value of these warrants totaled $28,141. Such amount was charged to other assets, net, and credited to additional paid-in capital and will be amortized over the life of the debentures. Maxim Group also acted as Placement Agent and received a cash fee in the amount of $50,000.

In connection with the issuance of the debentures, the Company incurred $1,106,135 of issuance costs, which primarily consisted of investment banker fees, legal and other professional fees. These costs have been recorded as additional expense during year 2006.

The gross proceeds of $8,000,000 are recorded as a current debenture liability. In addition, fair values attributed to the Investors' warrants in accordance with EITF issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock" are recorded as liabilities. The initial value related to the Investors' warrants is $690,642. An aggregate gain of $61,954 and $142,718 representing the change in fair value of warrants recognized during the three and nine months ended September 30, 2007, respectively.

In accordance with recent FASB guidance, due to certain factors, including a liquidated damages provision in the registration rights agreement, the Company values and accounts for the embedded conversion feature and the warrants related to the debentures as derivatives. Accordingly, these derivative liabilities are measured at fair value with changes in fair value reported in earnings as long as they remain classified as liabilities. The Company reassesses the classification at each balance sheet date. If the classification required under EITF No. 00-19 changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification.

EVENT OF DEFAULT

On March 16, 2007 our predecessor auditor withdrew their opinion on our previously filed financial statements for the years ended December 31, 2005, December 31, 2004 and December 31, 2003. As a result, on March 27, 2007, we notified the holders of the outstanding convertible debenture that we suspended use of the prospectus contained in our Registration Statement on Form S-1 (File No. 333-134127) that was declared effective on December 8, 2006, due to the lack of fiscal year end 2005 and 2004 audited financial statements and that they must cease selling under the prospectus. The suspension of the use of the prospectus after April 17, 2007, triggered an event of default under the registration rights agreement and the convertible debentures, and if any of the holders so elect, they could accelerate and demand payment under the debentures, in accordance with the registration rights agreement based on the following provisions.

a) "If, during the Effectiveness Period, either the effectiveness of the Registration Statement lapses for any reason or the Holder shall not be permitted to resell Registrable Securities under the Registration Statement for a period of more than 20 consecutive Trading Days or 60 non-consecutive Trading Days during any 12 month period, the Company has to pay 'Mandatory Default Amount' as the sum of (i) the greater of (A) 130% of the outstanding principal amount of this Debenture, plus all accrued and unpaid interest hereon, or (B) the outstanding principal amount of this Debenture, plus all accrued and unpaid interest hereon, divided by the Conversion Price on the date the Mandatory Default Amount is either (a) demanded (if demand or notice is required to create an Event of Default) or otherwise due or (b) paid in full, whichever has a lower Conversion Price, multiplied by the VWAP on the date the Mandatory Default Amount is either (x) demanded or otherwise due or (y) paid in full, whichever has a higher VWAP, and (ii) all other amounts, costs, expenses and liquidated damages due in respect of this Debenture."

b) "If any Event of Default occurs, the outstanding principal amount of this Debenture plus accrued but unpaid interest, liquidated damages and other amounts owing in respect thereof through the date of acceleration, shall become, at the Holder's selection, immediately due and payable in cash at the Mandatory Default Amount. Commencing 5 days after the occurrence of any Event of Default that results in the eventual acceleration of this Debenture, the interest rate on this Debenture shall accrue at an interest rate equal to the lesser of 18% per annum or the maximum rate permitted under applicable law."

Due to the provisions mentioned above and as per the terms of the Debenture, the Company has reclassified the principal amount of the Debenture of $8,000,000 and the principal amount of the new Debenture of $945,000 and the interest accrued thereon to current liabilities.

The Company accrued 2% as liquidated damages and 30% as mandatory default amount from the date of ineffectiveness of registration statement as follows:

($,000)	September 30, 2007 (unaudited)	
Liquidated damages	2%	$ 450
Mandatory default	30%	2,247

Total	$ 2,697

Such amounts have been recorded as liquidated damages liability as of September 30, 2007.

Following is the summary of convertible debenture:

($,000)	$8 million convertible debenture	$945,000 convertible debenture	Total (unaudited)
Balance December 31, 2006	$ 8,000	$ 945	$ 8,945
Principal payment:			
Redemption through shares	1,091	-	1,091
Cash payment	1,636	-	1,636
Balance September 30, 2007	$ 5,273	$ 945	$ 6,218

The Company issued 199,444 shares to redeem $1,090,909 of convertible note as of September 30, 2007.

8.2 Five Million Convertible Note

On February 7, 2007, PacificNet Games Limited (PacGames), a 51% owned subsidiary of the Company, entered into a definitive $5 million convertible secured note financing agreement with Pope Asset Management, LLC (Pope), an institutional investor. Proceeds of the financing are to provide PacGames with additional working capital to expand its gaming technology operations, to make further synergistic acquisitions in China and for general corporate purposes.

The $5 million convertible secured note issued to Pope matures on February 6, 2010. Subject to reaching certain net income milestones during fiscal year 2007, the note is convertible into an equity interest of PacGames ranging between 26% and 32%. The interest rate of the convertible note has initially been set at 8%, and shall increase to 15% if the note is not converted prior to maturity.

In connection with the issuance of the note, PacGames incurred issuance costs of $204,121, which primarily consisted of investment banker fees, legal and other professional fees. These costs have been capitalized and will be amortized over three years, the life of the note. Interest accrual as of September 30, 2007 amounted to $212,603.

Following is the summary of convertible debenture:

($,000)/(unaudited)		
Convertible debenture	$	5000
Accrued interest		218
Unamortized financing cost		(310)
Balance September 30, 2007	$	4,908

9. SEGMENT INFORMATION

The Company has classified its operating segments in accordance with SFAS No. 131 “DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION.” Operating segments comprise reporting entities that exhibit similar long-term financial performance based on the nature of the products and services with similar economic characteristics such as margins, business practices and target market. The four operating segments are as follows:

(1) Outsourcing Services - involves human voice services such as Business Process Outsourcing, CRM, call center, IT Outsourcing and software development services. These types of services are conducted through our subsidiaries EPRO, Smartime/Soluteck and PacificNet Solution Ltd.

(2) Telecom Value-Added Services (VAS) - primarily involves machine voice services such as Interactive Voice Response, SMS and related VAS, which are conducted through our subsidiaries such as AD, Wanrong, ChinaGoHi (discontinued), Linkhead (discontinued), Clickcom (discontinued) and Guangzhou 3G/Sunroom (discontinued). For example, Linkhead is a master reseller of NMS hardware and software platforms in China, and its voice cards are used as an integral part of voice hardware using CPCI industry control machines, and also by Media Servers to support access from PSTN and VoIP, Softswitch and 3G networks.

(3) Product (Telecom & Gaming) Services Group - involves communication and gaming products, GSM/CDMA/3G Products, Multimedia Communication Kiosks. This Group includes the following subsidiaries: PacificNet Communications Limited, iMobile, Allink, Poly, Take1 and PacificNet Games. PacificNet Games Limited (PacGames) is a leading developer of Asian electronic gaming machines, multi-player electronic gaming technology solutions and gaming related maintenance, IT, and distribution services for the leading hotel and casino operators based in the Macau and other Asian gaming markets.

(4) Other Business - other administrative, financial and investment services and non-core businesses such as PacificNet Power Limited (PacPower), Pacific Financial Services Limited, etc.

The Company's reportable segments are operating units, which represent the operations of the Company's significant business operations. Summarized financial information concerning the Company's reportable segments is shown in the following table. The "Other" column includes the Company's other insignificant services and corporate related items, and, as it relates to segment earnings / (loss), income and expense not allocated to reportable segments.

For The Three Months Ended September 30, 2007	Group 1. Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3. Products (Telecom & Gaming) ($)	Group 4. Other Business ($)	Total (unaudited) ($)
Net Revenues	3,971	470	5,305	56	9,802
(% of Total Revenues)	41%	5%	54%	1%	100%
Income / (Loss) from Operations	189	444	201	(697)	137
(% of Total Income)	138%	324%	147%	(509)%	100%
Total Assets	8,090	9,029	19,178	6,667	42,963
(% of Total Assets)	19%	21%	45%	16%	100%
Goodwill	3,964	461	1,833	-	6,258
Geographic Area	HK, PRC	PRC	Macau, HK, PRC	HK, PRC, USA	

For The Three Months Ended September 30, 2006	Group 1. Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3. Products (Telecom & Gaming) ($)	Group 4. Other Business ($)	Total (unaudited) ($)
Net Revenues	3,733	40	6,411	341	10,525
(% of Total Revenues)	35%		61%	3%	100%
Income / (Loss) from Operations	188	1	(191)	(616)	(618)
(% of Total Income)	(30)%	1%	31%	100%	100%
Total Assets	9,159	19,011	12,813	22,954	63,937
(% of Total Assets)	14%	30%	20%	36%	100%
Goodwill	3,936	12,920	1,529		18,385
Geographic Area	HK, PRC	PRC	Macau, HK, PRC	HK, PRC, USA	

For The Nine Months Ended September 30, 2007	Group 1. Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3. Products (Telecom & Gaming) ($)	Group 4. Other Business ($)	Total (unaudited) ($)
Net Revenues	11,700	1,429	14,729	232	28,090
(% of Total Revenues)	42%	5%	52%	1%	100%
Income / (Loss) from Operations	830	793	1,824	(2,163)	1,284
(% of Total Income)	65%	62%	142%	(168)%	100%
Total Assets	8,090	9,029	19,178	6,667	42,963
(% of Total Assets)	19%	21%	45%	16%	100%
Goodwill	3,964	461	1,833	-	6,258
Geographic Area	HK, PRC	PRC	Macau, HK, PRC	HK, PRC, USA	

For The Nine Months Ended September 30, 2006	Group 1. Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3. Products (Telecom & Gaming) ($)	Group 4. Other Business ($)	Total (unaudited) ($)
Net Revenues	10,312	106	18,262	3,652	32,332
(% of Total Revenues)	32%		56%	11%	100%
Income / (Loss) from Operations	734	4	98	(584)	252
(% of Total Income)	291%	2%	39%	(232%)	100%
Total Assets	9,159	19,011	12,813	22,954	63,937
(% of Total Assets)	14%	30%	20%	36%	100%
Goodwill	3,936	12,920	1,529		18,385
Geographic Area	HK, PRC	PRC	Macau, HK, PRC	HK, PRC, USA	

Product and service revenues classified by major geographic areas are as follows (in US$):

For the three months ended September 30, 2007	Hong Kong, Macau	PRC	United States	Total (unaudited)

Product revenues	2,731	2,574	--	5,305
Service revenues	3,609	888	--	4,497

For the three months ended September 30, 2006	Hong Kong, Macau	PRC	United States	Total (unaudited)
Product revenues	3,435	503	--	3,938
Service revenues	5,261	1,326	--	6,587

For the nine months ended September 30, 2007	Hong Kong, Macau	PRC	United States	Total (unaudited)
Product revenues	9,221	5,508	--	14,729
Service revenues	10,471	2,890	--	13,361

For the nine months ended September 30, 2006	Hong Kong, Macau	PRC	United States	Total (unaudited)
Product revenues	17,355	3,557	--	20,912
Service revenues	9,970	1,450	--	11,420

10. RELATED PARTY TRANSACTIONS

LOAN DUE FROM RELATED PARTIES

At September 30, 2007, there was a total loan receivable of approximately $2,227,000 due from related parties. Included in which were $845,000 due from PACT Power, $150,000 due from PACT Solutions, $604,000 due from PACT Linkhead and $628,000 due from shareholders and directors of certain of the Company's subsidiaries in connection with the acquisition of those subsidiaries. The amounts due from shareholders and directors of subsidiaries are comprised of $449,000 due from a shareholder of Yueshen, $64,000 due from a director of Smartime and $115,000 from a director of PACT Communications. Terms of these related parties loan receivables and payables are summarized below:

LOAN TO POWER

PacPower is an affiliated company, 15% owned by PacificNet, as of September 30, 2007. A convertible loan of $845,000 is outstanding from PacPower. The maturity date of loan was September 9, 2007. The loan is currently due on demand, non-interest bearing and unsecured.

LOAN TO SOLUTION

PacSo is an affiliated company, 15% owned by PacificNet, as of September 30, 2007. A convertible loan of $150,000 is outstanding from PacSo. The maturity date of loan was January 6 2007. The loan is currently due on demand, non-interest bearing and unsecured.

LOAN TO LINKHEAD

Linkhead is an affiliated company, 15% owned by PacificNet, as of September 30, 2007. A convertible loan of $604,000 is outstanding from Linkhead. The maturity date of loan is January 1, 2008.

LOAN TO YUESHEN'S SHAREHOLDER

As of September 30, 2007, there was a loan outstanding of $449,000 receivable from the shareholder of Yueshen. This loan is secured by 106,240 PacificNet shares. The maturity date of loan was February 16 2006. The loan is currently due on demand and non-interest bearing.

LOAN TO SOLUTECK'S DIRECTOR

As of September 30, 2007, there was a loan outstanding of $64,000 receivable from a director of Soluteck, due on January 17 for three consecutive years ending 2008. The interest rate for the loan is 8% per annum plus 5% penalty interest in case it has not been timely paid. The loan is collateralized with 100,000 PacificNet's shares owned by the borrowing director and Ms Iris Lo, and the remaining assets of Smartime Holding Ltd.

LOAN TO COMMUNICATIONS' DIRECTOR

As of September 30, 2007, there was a loan outstanding of $115,000 receivable from a director of Communications, due on August 31, 2007. The interest rate for the loan is 10% per annum plus 1% penalty interest per month in case of delinquency. The loan is secured by 30,000 PacificNet shares. The loan is currently in default.

LOAN DUE TO RELATED PARTIES

As of September 30, 2007, there was an outstanding loan payable of $681,000 due to related parties. Included in which was a loan payable of $187,000 to a shareholder of EPRO. The loan was advanced to Epro by a shareholder of EPRO on behalf of the Company for working capital purposes. The loan is due on August 4, 2010. Interest is charged at Hong Kong prime lending rate.

As of September 30, 2007, a loan of $201,000 was payable to a shareholder of Yueshen. The loan was advanced to Yueshen by a shareholder of Yueshen on behalf of the Company for working capital purposes.

MOABC is an affiliated company, 15% owned by PacificNet. As of September 30, 2007, there was an outstanding balance of $293,000 due to MOABC. The loan is unsecured, non-interest bearing and due on demand.

11. COMMITMENTS AND CONTINGENCIES

OPERATING LEASES - The Company leases warehouse and office space under operating leases with fixed monthly rentals. None of the leases included contingent rentals. Lease expense charged to operations for 2007 Q3 amounted to $562,000 (2006 Q3: $332,000). Future minimum lease payments under non-cancelable operating leases are $603,000 for the period from October 2007 to September 2008, and $155,000 for the period from October 2008 to September 2011, respectively.

RESTRICTED CASH - Term deposit of $239,000 has been pledged to certain financial institutions for bank line overdraft protection of Epro.

BANK LINE OF CREDIT - As of September 30, 2007, the Company's outstanding bank line of credit were as follows:

(i) Epro has an overdraft banking facility of up to $50,000 with certain banking institutions, which is secured by a pledge of its fixed deposits of $239,000. Interest is charged at Hong Kong Prime Rate and payable at the end of each calendar month or the date of settlement, whichever is earlier.

(ii) Smartime has an overdraft banking facility of up to $131,000 with a Hong Kong banking institution. This overdraft facility is secured by a personal deposit account of a director of Smartime.

BANK LOANS- Bank loans represent the following at September 30, 2007:

	September 30, 2007 Unaudited	December 31, 2006 Audited Restated
Secured [1]	$ 757	$ 1,668
Unsecured	2,062	543
Less: current portion	768	576
Non current portion	$ 2,051	$ 1,635

[1] The loans were secured by the following: joint and several personal guarantees executed by certain directors of the subsidiary of the Company; corporate guarantee executed by a subsidiary of the Company; third legal charge over a property owned by a subsidiary of the Company; and pledged bank deposits of $239,000 (2006: $234,000) of a subsidiary of the Company.

Aggregate future maturities of borrowing for the next five years are as follows:

(US$000s)	October 2007 to September 2008	October 2008 to September 2009	October 2009 to September 2010	October 2010 to September 2011	October 2011 to September 2012	Thereafter	TOTAL (unaudited)
Beijing PACT office mortgage (1)	54	57	60	64	67	746	1,048
Shenzhen PACT office mortgage (2)	23	25	26	28	29	635	766
Sub-total	77	82	86	92	96	1,381	1,814

Bank loan of Epro (3)	443	298	16	-	-	-	757
AR factoring loans (3)	248	-	-	-	-	-	248
Sub-total	691	298	16	-	-	-	1,005
TOTAL	768	380	102	92	96	1,381	2,819

(As at December 31, 2006, the aggregate future maturities of borrowing for the next five years were as follows: 2007: $576,000, 2008: $477,000, 2009: $268,000, 2010: $59,000, 2011: $62,000, thereafter: $769,000)

(1) Fixed mortgages expiring in 2012 at interest rate of 5.5% per annum.
(2) Fixed mortgage expiring in 2012 at interest rate of 6.2% per annum.
(3) Interest rates charged range from Hong Kong Prime Lending Rate to Prime + 2%.

17

CAPITAL LEASE OBLIGATIONS - The Company leases various equipments under capital leases expiring in 2009. Aggregate minimum future lease payments under capital leases for each of the next two years are as follows: 2008: $90,000, 2009: $62,000, and thereafter: none.

	Aggregate future lease payments (unaudited)
2008	$ 90,000
2009	$ 62,000
Total	$ 152,000
Current portion	$ 90,000
Non-current portion	$ 62,000

12. NET ASSETS HELD FOR DISPOSITION

Sale of Interest in Linkhead Technology Bejing Limited. ("Linkhead")

On May 20, 2007, the Company entered into a definitive agreement to sell its 36% equity interest in Linkhead, a PRC limited liability corporation engaged in the business of resaling of NMS hardware and software platforms in China, to Mr. Mu Yingliang, a resident of People's Republic of China. Consideration for the 36% interest of Linkhead was RMB10,000 (or US$1,295), to be paid within 90 days after signing of the agreement. The Company's interest in Linkhead decreased from 51% to 15% after the transaction. Absent any explicit closing conditions contained in the said agreement, the disposal was completed upon title transfer during the third quarter of 2007.

Sale of Interest in PacificNet Telecom Solution Inc. ("PacTelso")

On May 20, 2007, the Company entered into a definitive agreement to sell its 36% equity interest in PacTelso, an intermediate holding company registered under the laws of British Virgin Islands, to Mr. Mu Yingliang, a resident of People's Republic of China. Consideration for the 36% interest of PacTelso was RMB10,000 (or US$1,295), to be paid within 90 days after signing of the agreement The Company's interest in PacTelso decreased from 51% to 15% after the transaction. Absent any explicit closing conditions contained in the said agreement, the disposal was completed upon title transfer during the third quarter of 2007.

Sale of Interest in PacificNet Solutions Limited. ("PacSo")

On May 18, 2007, the Company entered into a definitive agreement to sell its 45% equity interest in PacSo, a company registered under the laws of Hong Kong SAR, China and engaged in systems integration, software application, and e-business solutions services, to Mr. Alex Au, a resident of Hong Kong SAR, China. Consideration for the 45% interest of PacSo was HK$4,500 (or US$583), to be paid within 90 days after signing of the agreement. The Company's interest in PacSo decreased from 60% to 15% after the transaction. Absent any explicit closing conditions contained in the said agreement, the disposal was completed upon title transfer during the third quarter of 2007.

Sale of Interest in PacificNet Power Limited ("PacPower")

On May 18, 2007, the Company entered into a definitive agreement to sell its 36% equity interest in PacPower, a company registered under the laws of Hong Kong SAR, China and engaged in air-conditioning contracting and consulting businesses, to Mr. Alex Au, a resident of Hong Kong SAR, China. Consideration for the 36% interest of

PacPower was HK$3,600 (or US$466), to be paid within 90 days after signing of the agreement. The Company's interest in PacPower decreased from 51% to 15% after the transaction. Absent any explicit closing conditions contained in the said agreement, the disposal was completed upon title transfer during the third quarter of 2007.

Sale of Interest in MOABC.com ("MOABC")

On May 20, 2007, the Company entered into a definitive agreement to sell its 5% equity interest in MOABC, a PRC limited liability corporation engaged in the business of value-added services platform providing, to Mr. Jack Ou, a resident of People's Republic of China. Consideration for the 5% interest of MOABC was RMB5,000 (or US$647), to be paid within 90 days after signing of the agreement. The Company's interest in MOABC decreased from 20% to 15% after the transaction.

Sale of Interest in PacificNet Clickcom Limited ("Clickcom")

On May 15, 2007, the Company entered into a definitive agreement to sell its 36% entire interest in PacificNet Clickcom Limited. ("Clickcom"), a leading Value-Added Services (VAS) company in China, to Mr. Ou Zhenbin, a Chinese residence. Consideration for the 36% interest of Clickcom was RMB10,000 to be paid in cash within 90 days after the agreement signing. The Company's interest in Clickcom decreased from 51% to 15% after the transaction. On November 22, 2007, the said agreement was revoked by the Seller as a result of non-payment by the Buyer, Mr. Ou. The Company's plan to dispose of its interest in Clickcom remained unchanged and continued as held for disposal as of September 30, 2007. Since the S&P agreements was terminated in the subsequent period proforma information is presented as if the Clickcom is held for disposal as of September 30, 2007 (See note 17)

Sale of Interest in Guangzhou 3G Information Technology Co., Ltd. ("Guangzhou 3G")

On April 30, 2007, the Company entered into a definitive agreement to sell its 51% entire interest in Guangzhou 3G Information Technology Co., Ltd. ("Guangzhou 3G"), a leading provider of Customer Relationship Management (CRM), mobile internet, e-commerce and gaming technology in China, Consideration for the 51% interest of Guangzhou 3G was US$6 million, to be paid in cash in 5 installments over 7 months after the agreement signing. The Company acquired 51% controlling interest in Guangzhou 3G in March of 2005 for US$5.5 million consideration which was paid partially in cash and mostly in PACT stock. The Company's interest in Guangzhou 3G decreased from 51% to 0% after the transaction. Absent any explicit closing conditions contained in the said agreement, the disposal was completed upon title transfer during the second quarter of 2007.

Information relating to the operations of the subsidiaries up to the periods of disposal during the nine month period ended September 30, 2007 is as follows:

(In US$ thousands)	Linkhead	Clickcom	Power	PacTelso	Solutions	MOABC	3G	Total (unaudited)
Income (loss) from discontinued operations	(8)	(3)	-	-	-	-	262	250
Gain (loss) from discontinued operations	(300)	-	340	1	(0)	5	(971)	(925)
Net assets held for disposition (remaining interest)		810	-	-	-	-	-	810

13. ACQUISITION

TAKE 1 TECHNOLOGIES GROUP LIMITED

On January 05, 2007, we entered into an agreement for PacificNet to exercise the option to acquire an additional 31% interest in Take 1. The completion date for the new Securities Subscription Agreement was January 05, 2007, with a contingent consideration of $965,505 (to be paid entirely with shares of PacificNet: 149,459 PACT Shares, valued at $6.46 per share). As a result, PacificNet has become the majority and controlling shareholder of Take1 with our ownership percentage increasing from 20% to 51%.

An initial equity investment of 30% in Take 1 was made in April 2004 by the Company, through its subsidiary PacificNet Strategic Investment Holdings Limited, for a consideration of $1,156,812, comprising $385,604 in cash and $771,208 in 149,459 PacificNet shares at $5.16 per share. PacificNet's interest in Take 1 was reduced to 20% in the year 2005 from 30% as a result of PacificNet repurchasing an aggregate of 149,459 at nominal value.

Summarized below were the assets acquired and liabilities assumed for Take 1 in the acquisition:

Estimated fair values/(unaudited):	
Current Assets	$ 106,422
Intangible asset	64,665
Total Assets Acquired	171,087
Liabilities assumed	(728,156)
Net assets acquired	(557,069)
Investment on equity method	385,604
Loss from Investment	(285,260)

Goodwill	$ 657,413

At September 30, 2007, goodwill of $657,413 represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired and is not deductible for tax purposes and the total amount of goodwill is reported under reportable segment for Products (Telecom & Gaming).

In accordance with SFAS 142, goodwill is not amortized but is tested for impairment at least annually. The purchase price allocation for Take 1 acquisition is based on a management's estimates and overall industry experience. Immediately after the signing of the definitive agreement, the Company obtained effective control over Take 1. Accordingly, the operating results of Take 1 have been consolidated with those of the Company starting January 05, 2007. Pursuant to SFAS 141 "Business Combinations", the earn-out consideration is considered contingent consideration, which will not become certain until the audited combined after-tax loss of US$640,000 for the nine months ended September 30, 2007 is available. Accordingly, the contingent consideration of 120,000 shares has not been reflected in the consolidated financial statements of the Company as of September 30, 2007.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE QUARTER ENDED September 30, 2007 AND 2006

The following is an un-audited pro forma consolidated financial information for the nine month ended September 30, 2006 and 2007, as presented below, reflects the results of operations of the Company assuming the acquisition occurred on January 1, 2006 and 2007, respectively, and after giving effect to the purchase accounting adjustments. These pro forma results have been prepared for information purposes only and do not purport to be indicative of what operating results would have been had the acquisitions actually taken place on January 1, 2006 and 2007, respectively, and may not be indicative of future operating results.

(un-audited and in thousands of U.S. dollars)	Nine months ended September 30	
	2007	2006
Revenue	28,090	33,568
Operating income	1,284	(1,260)
Net profit	$ (639)	$ 503
Earnings per share – basic	$ (0.05)	$ 0.05
Earnings per share – diluted	$ (0.05)	$ 0.05

Accordingly, PacificNet included the financial results of Take 1 in its consolidated 2007 financial results from January 5, 2007 through September 30, 2007.

14. INVESTMENTS IN AFFILIATED COMPANIES

Investments in affiliated companies are consisted of the following as of September 30, 2007:

(US$ thousands)/(unaudited)	COLLATERAL/OWNERSHIP % AND BUSINESS DESCRIPTION	
INVESTMENTS IN AFFILIATED COMPANIES:	AMOUNT	DESCRIPTION
Glad Smart	$30	15% ownership interest
MOABC	$(14)	15% ownership interest
Community Media Co.	$4	5% ownership interest
Solutions	–	15% ownership interest (1)
Linkhead	$333	15% ownership interest
Power	–	15% ownership interest (1)
Total	$353	

(1) Amounts less than one thousand dollars are excluded.

15. LEGAL PROCEEDINGS.

1. Lawsuit between PacificNet Power Limited and Johnson Controls Hong Kong Limited (JCHKL), a subsidiary of Johnson Controls Inc. (NYSE:JCI) (www.jci.com)

On January 19, 2007, Johnson Controls Hong Kong Limited filed a claim against PacificNet Power Limited (a 51% owned subsidiary of PacificNet) in the High Court of the Hong Kong Special Administrative Region seeking HK$4,800,000 as payment for services rendered to replace 3 sets of rane water-cooled chillers, together with energy saving performance (the "Chiller System"), at the Fortress Tower in Hong Kong.

In connection with the claim, PacificNet Power reviewed a letter from its client, China Weal Property Management Ltd., dated January 22, 2007 stating that the construction work by JCHKL had not been completed as of the date of the letter, and that certain violations itemized in a letter issued by the Hong Kong Environment Protection Department (EPD) (Noise Abatement Notice No. N806030) addressed to JCHKL with respect to acoustic problems with JCHKL's equipment had not been abated. Further, JCHKL was to pay penalties between HK$100,000 and HK$200,000 assessed by the JCHKL for failing to fix the noise problem on the roof of Fortress Tower.

The board of directors of PacificNet Power Limited has reviewed the case with its client, China Weal Property Management Ltd., and our Hong Kong legal counsel and it is our belief that the project work undertaken JCHKL is defective in numerous aspects, as evidenced by the letter from government letter issued by EPD. As a result, we believe the construction work was not been completed by JCHKL, and therefore, JCHKL is not entitled to payment for its services.

On February 7, 2007, we instructed our Hong Kong legal counsel to issue a Defense and Counterclaim to JCHKL to counter-claim that (i) JCHKL's construction work has not complied with the applicable rules and regulations of various government authorities in Hong Kong; (ii) the Chiller System provided by JCHKL was defective and merchantable unfit and JCHKL has failed and/or refused to rectify such defective works; and (iii) JCHKL shall return the work deposit in the amount of HK$1,500,000 to PacificNet Power Limited and shall compensate and keep PacificNet Power Limited indemnified against all the loss and damages suffered as a result of any claims from the China Weal Property Management Ltd, the employer and the potential tenants of Fortress Tower.

The case is now proceeding to the stage of fixing a date for trial in the High Court of Hong Kong and we intend to vigorously defend ourselves against the allegations. We are unable to predict the outcome of these actions, or a reasonable estimate of the range of possible loss, if any.

2. Lawsuit between PacificNet Power Limited and Johnson Controls Hong Kong Limited (JCHKL), a subsidiary of Johnson Controls Inc. (NYSE:JCI) (www.jci.com)

On or about December, 2005, Johnson Controls Hong Kong Limited approached PacificNet Power Limited (a 51% owned subsidiary of PacificNet) and made a representation that they had submitted a tender to "The Incorporated Owners of Nan Fung Centre, Tsuen Wan ("the Employer") for the "construction and replacement works of existing air-cooled chiller plant by new water-cooled chiller plant for Tsuen Wan Nan Fung Centre and energy saving performance contract" ("the Construction and Replacement Works Contract"). JCHKL invited and induced PacificNet Power Limited to act as the main contractor for the Contract and it would then act as a sub-contractor.

PacificNet Power also expressly made known to JCHKL that the said construction and replacement works and the guaranteed energy saving should meet all the tender requirements if PacificNet Power accepted the invitation to act as the main contractor for the Contract, and PacificNet Power further said that if there should be any quality defects with the system and/ or the construction work, the Employer and/ or their prospective tenants would claim against JCHKL and JCHKL should compensate.

PacificNet Power however received some correspondences and complaints from the Employer about the poor and/ or sub-standard works done by JCHKL. PacificNet Power, after separate investigation, discovered the poor workmanship and sub-standard works done by JCHKL. Accordingly, the Employer and/ or their representatives have delayed the monthly installments payment to PacificNet Power.

On April 23, 2007, we instructed our lawyers issued a letter to the Defendant requesting and demanding them, being the sub-contractor of the Construction and Replacement Works Contract, to take immediate rectification action within seven days from the date of the said letter to (i) rectify and complete all outstanding defective works of the Construction and Replacement Works Contract; (ii) replace the water-cooled chiller plant and/or equipments which are not conformed with the requirements of the tender documents previously submitted by the Defendant to the Employer; and (iii) improve the poor performance of energy saving of the new water-cooled chiller plant so that it would conform with their guarantee made on 21 December, 2005 to PKL and the employer.

Despite the said letter, JCHKL had failed and/ or refused to rectify and complete all outstanding works and/ or replace the defective system. And therefore PacificNet Power claims against JCHKL for: (i) refund HK$6,414,300.00, being the Contract Price paid by PacificNet Power to JCHKL; (ii) costs and expenses incurred by Power to rectify all defective works of the Contract; (iii) all damage and loss suffered by PacificNet Power, and further and other relief.

On July 25, 2007, JCHKL issued a Defense and Counterclaim to PacificNet Power to counter-claim that: (i) a concrete base was discovered after the existing dismantled radiators was not indicated in tender drawings nor could it be revealed by site visit; (ii) JCHKL could not have carried out the works under the Contract without first demolishing the said concrete base; (iii) by a letter from JCHKL to PacificNet Power dated 22 May, 2007, PacificNet Power was informed additional works had been carried out by JCHKL; (iv) a sum of HK$30,000 is still due and owing by PacificNet Power to JCHKL.

The case is now proceeding to the stage of fixing a date for trial in the High Court of Hong Kong. We are unable to predict the outcome of these actions, or a reasonable estimate of the range of possible loss, if any.

3. Lawsuit between PacificNet Inc. and HLB Hodgson Impey Cheng (HLB or Defendant), a firm of Chartered Accountants and Certified Public Accountants in Hong Kong

On September 20, 2007, PacificNet Inc. filed a claim against its former auditors HLB Hodgson Impey Cheng (HLB), a firm of Chartered Accountants and Certified Public Accountants, in the High Court of the Hong Kong Special Administrative Region seeking refund of the professional fees, compensation of professional fees and expenses for

Company to engage and deploy new auditors to take over the incomplete audit works from the Defendant and returning and/or providing all relevant accounting records, vouchers, audit program and working papers retained by the Defendant and losses and damages incurred.

The case is now proceeding to the stage of fixing a date for trial in the High Court of Hong Kong. We are unable to predict the outcome of these actions, or a reasonable estimate of the range of possible loss, if any.

16. CURRENT VULNERABILITY DUE TO CERTAIN CONCENTRATIONS

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, by the general state of the PRC's economy. The Company's business may be influenced by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

17. SUBSEQUENT EVENTS

Revocation of Sale & Purchase Agreement of PacificNet Clickcom Limited ("Clickcom")

On May 15, 2007, the Company entered into a definitive agreement to sell its 36% entire interest in PacificNet Clickcom Limited. ("Clickcom"), a leading Value-Added Services (VAS) company in China, to Mr. Ou Zhenbin, a Chinese residence. Consideration for the 36% interest of Clickcom was RMB10,000 to be paid in cash within 90 days after the agreement signing. The Company's interest in Clickcom decreased from 51% to 15% after the transaction. On November 22, 2007, the said agreement was revoked by the Seller as a result of non-payment by the Buyer.

Following is the unaudited proforma consolidated financial information as if the Guangzhou 3G was not disposed of as of May 15, 2007 and held for disposal as of September 30, 2007.

(un-audited and in thousands of U.S. dollars)	Nine months ended September 30	
	2007	2006
Income (loss) from continued operations	17	(111)
Income (loss) from discontinued operations	250	980
Net income (loss)	(645)	394
Earnings per share – basic	(0.05)	0.04
Earnings per share – diluted	(0.05)	0.04

Acquisition Of Guangdong Poly Blue Express Communications Co.Ltd (Guangdong Poly)

On September 5, 2007, the company entered into an agreement to acquire (subject to meeting of certain conditions) an aggregate of 51% equity interest in Guangdong Poly Blue Express Communications Co., Ltd. (Guangdong Poly). Guangdong Poly is a leading operator approved by China's Welfare Lottery Center to develop and operate real-time electronic paperless lottery services in China, in accordance to the rules and regulations set by China's Welfare Lottery Center. Total consideration payable for the purchase of Guangdong Poly was US$2 million, in which US$1 million payable in PACT restricted shares and US$1 million payable in cash.

Due to outstanding closing conditions, the acquisition was not closed until October 25, 2007.

IROQUOIS MASTER FUND, LTD. vs. PACIFICNET INC.

On October 3, 2007 Iroquois Master Fund, Ltd. filed a complaint in the Supreme Court of the State of New York against PacificNet Inc., claiming that the Company is in default for failure to pay principal and interest under the Amended and Restated Convertible Debenture due March 2009 (the Amended Debenture") in the principal amount of $3,000,000 and interest on the Convertible Debenture due February 2009 (the "New Debenture") in the principal amount of $420,000.

As of October 2, 2007, Iroquois claims that the outstanding principal amount of the Amended Debenture was$2,045,452, and accrued but unpaid interest amount was $30,682. Iroquois claims that, as of October 2, 2007, the mandatory default amount, as calculated under the terms of the Amended Debenture due and owing is $2,698,974.

As of October 2, 2007, Iroquois claims that the outstanding principal amount of the New Debenture was $420,000,and accrued but unpaid interest amount was $6,300.

Iroquois claims that, as of October 2, 2007, the mandatory default amount, as calculated under the terms of the New Debenture, due and owing is $554,190.

As of the date of the complaint, Iroquois Master Fund, Ltd. was seeking damages of $3,253,163.80 in the aggregate, together with any accrued but unpaid interest through the date of judgment. Iroquois Master Fund, Ltd. also demanded for the reimbursement of its attorney fees and other costs and expenses incurred together with costs and disbursements of this action and such other and further relief as to the court seems just and proper.

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

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE INFORMATION CONTAINED IN THE FINANCIAL STATEMENTS OF THE COMPANY AND THE NOTES THERETO APPEARING ELSEWHERE HEREIN AND IN CONJUNCTION WITH THE MANAGEMENT'S DISCUSSION AND ANALYSIS SET FORTH IN THE COMPANY'S ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2006, AS AMENDED.

PRELIMINARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained in this Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These include statements about the Company's expectations, beliefs, intentions or strategies for the future, which are indicated by words or phrases such as "anticipate," "expect," "intend," "plan," "will," "the Company believes," "management believes" and similar words or phrases. The forward-looking statements are based on the Company's current expectations and are subject to certain risks, uncertainties and assumptions, including those set forth in the discussion under "Description of Business," including the "Risk Factors" described in that section, and "Management's Discussion and Analysis or Plan of Operation." The Company's actual results could differ materially from results anticipated in these forward-looking statements. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements.

FACTORS THAT COULD AFFECT FUTURE RESULTS

Factors that might cause actual results, performance or achievements to differ materially from those projected or implied in such forward-looking statements include, among other things:

—the impact of competitive products;
—changes in laws and regulations;
—adequacy and availability of insurance coverage;
—limitations on future financing;
—increases in the cost of borrowings and unavailability of debt or equity capital;
—the inability of the Company to gain and/or hold market share;
—exposure to and expense of resolving and defending liability claims and other litigation;
—consumer acceptance of the Company's products;
—managing and maintaining growth;
—customer demands;
—market and industry conditions,
—the success of product development and new product introductions into the marketplace;
—the departure of key members of management, and
—the effect of the United States War on Terrorism, as well as other risks and uncertainties that are described from time to time in the Company's filings with the Securities and Exchange Commission.

Regarding one of our subsidiaries, for example, Epro is engaged in the business of providing outsourced call center services with over 15 years of field experience in Hong Kong and China. The factors that could affect current and future results are as follows:

—insufficient sales forces for business development & account servicing;
—lack of PRC management team in operation;
—less familiarity on partners' product knowledge;
—deployment costs of a new HR application and the costs to upgrade the call center computer system;
—increasing operations costs (cost of salaries, rent, interest rates & inflation) under rising economy in Hong Kong;
—insufficient brand awareness initiatives in the market;
—salary increases due to an active labor market in Hong Kong and GuangZhou; and
—increasing competition of call center solutions in the Hong Kong and PRC markets.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis or plan of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an on-going basis, we evaluate our estimates, including those related to accounts receivable reserves, provisions for impairment losses of affiliated companies and other intangible assets, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management believes the following critical accounting policies reflect our more significant estimates and assumptions used in the preparation of our consolidated financial statements:

Allowance For Doubtful Accounts

We evaluate the collectibility of our trade receivables based on a combination of factors. We regularly analyze our significant customer accounts, and, when we become aware of a specific customer's inability to meet its financial obligations to us, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position, we record a specific reserve for bad debt to reduce the related receivable to the amount we reasonably believe is collectible. We also record reserves for bad debt for all other customers based on a variety of factors including the length of time the receivables are past due, the financial health of the customer, macroeconomic considerations and historical experience. If circumstances related to specific customers change, our estimates of the recoverability of receivables could be further adjusted. In the event that our trade receivables become uncollectible, we would be forced to record additional adjustments to receivables to reflect the amounts at net realizable value. The accounting effect of this entry would be a charge to earnings, thereby reducing our net earnings. Although we consider the likelihood of this occurrence to be remote based on past history and the current status of our accounts, there is a possibility of this occurrence.

In the beginning of the third quarter of 2006, the Chinese government announced that it would implement several new policies regarding mobile phone value-added service providers effective from July 10, 2006. These policies include a “double confirmation” policy and the requirement that value-added service providers provide one-month trial subscriptions. By requiring that mobile phone customers “double-confirm” their intention to purchase services, and by requiring free subscriptions, the Chinese government has negatively affected value-added service providers.

Inventory

Our inventory purchases and commitments are made in order to build inventory to meet forecasted demand for our products. We perform a detailed assessment of inventory for each period, which includes a review of, among other factors, demand requirements, product life cycle and development plans, component cost trends, product pricing and quality issues. Based on this analysis, we record adjustments to inventory for excess, obsolescence or impairment, when appropriate, to reflect inventory at net realizable value. Revisions to our inventory adjustments may be required if actual demand, component costs or product life cycles differ from our estimates. In the event we were unable to sell our products, the demand for our products diminished, and/or other competitors offered similar or better products, we would be forced to record an adjustment to inventory for impairment or obsolescence to reflect inventory at net realizable value. The accounting effect of this entry would be a charge to earnings, thereby reducing our net earnings.

Income Taxes

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We have considered future market growth, forecasted earnings, future taxable income, and the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies in determining the need for a valuation allowance. We currently have recorded a full valuation allowance against net deferred tax assets as we currently believe it is more likely than not that the deferred tax assets will not be realized. In the event we determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to earnings in the period such determination is made. Likewise, if we later determine that it is more likely than not that the net deferred tax assets would be realized, the previously provided valuation allowance would be reversed.

Contingencies

We may be subject to certain asserted and unasserted claims encountered in the normal course of business. It is our belief that the resolution of these matters will not have a material adverse effect on our financial position or results of operations, however, we cannot provide assurance that damages that result in a material adverse effect on our financial position or results of operations will not be imposed in these matters. We account for contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated.

Valuation of Long-Lived Assets Including Goodwill and Purchased Intangible Assets

We review property, plant and equipment, goodwill and purchased intangible assets for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Our asset impairment review assesses the fair value of the assets based on the future cash flows the assets are expected to generate. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. This approach uses our estimates of future market growth, forecasted revenue and costs, expected periods the assets will be utilized and appropriate discount rates. Such evaluations of impairment of long-lived assets including goodwill arising on a business combination and purchased intangible assets are an integral part of, but not limited to, our strategic reviews of our business and operations performed in conjunction with restructuring actions. When an impairment is identified, the carrying amount of the asset is reduced to its estimated fair value. Deterioration of our business in a geographic region or within a business segment in the future could also lead to impairment adjustments as such issues are identified. The accounting effect of an impairment loss would be a charge to earnings, thereby reducing our net earnings.

Convertible Debt

In accordance with recent FASB accounting guidance, due to certain factors, including a liquidated damages provision in the registration rights agreement and an indeterminate amount of shares to be issued upon conversion of the debentures, the Company values and accounts for the embedded conversion feature related to the Debentures, the Investors' warrants, and the registration rights as derivative liabilities. Accordingly, these derivative liabilities are measured at fair value with changes in fair value reported in earnings as long as they remain classified as liabilities. The Company reassesses the classification at each balance sheet date. If the classification required under EITF No. 00-19 changes as a result of events during the period, the contract should be reclassified as of the date of the event that caused the reclassification.

The fair value of these derivative instruments, as determined by applying the Black-Scholes valuation model, is adjusted quarterly. The Black-Scholes valuation model requires the input of highly subjective assumptions, including the expected stock price volatility. Additionally, although the Black-Scholes model meets the requirements of SFAS 133, the fair values generated by the model may not be indicative of the actual fair values as our derivative instruments have characteristics significantly different from traded options. Accordingly, the results obtained could be significantly different if other assumptions were used. The effect of this entry would be a charge to net earnings, thereby either increasing or reducing our net earnings based upon the assumptions used and the results obtained.

NATURE OF THE OPERATIONS OF THE COMPANY

NATURE OF BUSINESS

PacificNet Inc. (http://www.PacificNet.com) is a leading provider of gaming technology, e-commerce, and Customer Relationship Management (CRM) in China. Our gaming products are specially designed for the Chinese and Asian gamers, and we focus on integrating localized Chinese and Asian themes and content, advanced graphics, digital sound effects and popular domestic music, with secondary bonus games and jackpots. Our gaming products include: Multi-player Electronic Table Games - Baccarat, Sicbo, Fish-Prawn-Crab, and Roulette machines, server based games (SBG) with multiple client betting stations, slot and bingo machines, video lottery terminals (VLTs), amusement with prices (AWP) machines, gaming cabinet and client/server system designs, online i-gaming software design, and multimedia entertainment kiosks. PacificNet's gaming clients include the leading hotels, casinos, and gaming operators in Macau, Asia, and Europe, and our ecommerce and CRM clients include the leading telecom companies, banks, insurance, travel, marketing and business services companies and telecom consumers in Greater China such as China Telecom, China Mobile, Unicom, PCCW, Hutchison Telecom, Bell24, Motorola, Nokia, SONY, TCL, Huawei, American Express, Citibank, HSBC, Bank of China, Bank of East Asia, DBS, TNT, China and Hong Kong government. PacificNet employs about 1,200 staff in its various subsidiaries throughout China with offices in Hong Kong, Beijing, Shanghai, Shenzhen, Guangzhou, Macau and Zhuhai China, USA, and the Philippines.

PacificNet's Gaming Products:

Our gaming products are specially designed for the Chinese and Asian gamers, and we focus on integrating localized Chinese and Asian themes and content, advanced graphics, digital sound effects and popular domestic music, with secondary bonus games and jackpots. Our gaming products include:

• Multi-player Electronic Table Games: Baccarat, Sicbo, Fish-Prawn-Crab, and Roulette Machines, server based games (SBG) with multiple client betting stations.
• Slot Machines
• Bingo and Keno Machines
• Video Lottery Terminals (VLTs)
• Server-Based Gaming Machines (SBG)
• Amusement With Prices (AWP) Machines
• Online iGaming Software Development
• Client-Server Gaming Systems
• CMM Level 3 Certified Gaming Software Development Center in China with 200 Professional Software Developers
• Gaming Systems, Cabinet Design and Sales, Parts Sales, OEM Games. We design and sell gaming machine cabinets, replacement parts.

PacificNet's Business Units:

1. Gaming Technology: Electronic Gaming Machines, Mobile Games, i-Gaming Software.

2. Legacy Business: CRM, E-commerce and Telecom Products

Our goal is to take a leading role in providing customer relationship management (CRM) and gaming technology, which are rapidly expanding business sectors in Asia.

PaificNet's Major Operating Subsidiaries

— **PacificNet Games Limited (PacGames)**, is a leading provider of Asian multi-player electronic gaming machines, gaming technology solutions, gaming related maintenance, IT and distribution services for the leading hotel, casino and slot hall operators based in Macau, China and other Asian gaming markets.
— Take1 Technologies (www.take1technologies.com) , is in the business of designing and manufacturing electronic multimedia entertainment kiosks, coin-op kiosks and machines, electronic gaming machines (EGM), bingo and slot machines, AWP (Amusements With Prizes) games, server-based downloadable games systems, and Video Lottery Terminals (VLT) such as Keno and Bingo machines, including hardware, software, and cabinets.
— Pacific Solutions Technology, is a CMM Level 3 certified software development center with over 200 software programmers located in Shenzhen, China, and specializes in the development of client-server systems, internet e-commerce software, online and casino gaming systems and slot machines, banking and telecom applications using Microsoft Visual C++, Java, and other rapid application development tools.
— PacificNet Epro (www.EproTel.com.hk): CRM Call Center and Customer Services Outsourcing
— PacificNet Clickcom (www.clickcom.com.cn), MOABC.com : VAS,SP,(SMS, WAP)
— Guangzhou Wanrong (www.my2388.com) : VAS, SP, (SMS,MMS,IVR,WAP, Java Games)
— PacificNet Communications Limited,
— iMobile, (www.imobile.com.cn, www.18900.com, wap.17wap.com)

PacificNet Gaming Technology

1. Participation games: company-owned gaming machines that we lease based upon any of the following payment methods are referred to as participation games: (1) a percentage of the net win of the gaming machines, (2) fixed daily fees, or (3) in the case of wide-area progressive gaming machines, a percentage of the amount wagered or a combination of a fixed daily fee and a percentage of the amount wagered.
2. Wide Area Game Network, Community Gaming: electronically link gaming machines that are located across multiple casinos within a gaming jurisdiction. The linked gaming machines contribute to and compete for large, system-wide progressive jackpots and are designed to increase gaming machine play for participating casinos by giving the players the opportunity to win a larger jackpot than on a stand-alone gaming machine.
3. Local Area Progressive Jackpots (LAP) participation games: electronically links gaming machines that are located within a single casino to a progressive jackpot for that specific casino.

4. Video Lottery Terminals: video gaming machines featured with localized Chinese and Asian themes and contents, advanced graphics, digital sound effects and music and incorporate many of the same features from our other gaming machines.
5. Server-based Gaming: a gaming system in which game content and peripherals are configured, maintained and refreshed over a network that links groups of gaming machines to a remote server that also enables custom configuration by operators and central determination of game outcomes.

Gaming Market Overview on Macau, China

As of the end of 2006, Macau (a Special Administrative Region of the People's Republic of China) has become the largest and fastest-growing gaming market in the world, and surpassed the Las Vegas Strip in total revenues. According to statistics provided by Macau government, in 2006, Macau's gaming revenues exceeded US$7 billion (MOP 56.2 billion patacas), surpassing the Las Vegas Strip gaming revenues of US$6.6 billion. Macau borders Zhuhai City of Guangdong Province of China, one of the country's wealthiest and most developed regions and is an hour away from Hong Kong via ferry. In 2006, the number of tourists visiting Macau reached an all-time record of 22 million, an increase of 17 percent compared with 2005, of which 55% or 12 million visitors were from mainland China. At the end of 2006, there were 22 casinos, 83 hotels and similar establishments in Macau with close to 13,000 rooms. By 2010, the number of tourists is expected to nearly double to nearly 30 million visitors per year. Approximately one billion people live within a three-hour flight of Macau. Numerous hotel, gaming, and other projects are in the works in Macau which are expected to add over 10,000 guest rooms and over 20,000 live entertainment seats in eight separate venues. The number of hotel-casinos in operation and in development in Macau continues to grow, including well-known Chinese names such as Galaxy and Melco, and famous Las Vegas names such as the Sands, the Venetian, Wynn Resort and Crown Macau. With the disposable income of the average Chinese on the rise, Macau's gaming and entertainment market is expected to grow for years to come. Macau is the only area in China where gambling is legal.

RESULTS OF OPERATIONS

REVENUES

Revenues for the three and nine months ended September 30, 2007 amounted to $9,802,000 and $28,090,000, a year-over-year decline of 7% and 13% as compared to $10,525,000 and $32,332,000 for the same periods of prior year, respectively. The year-over-year decrease in revenues was mainly due to contraction of the Company's low margin Mobile phone wholesaling businesses in Greater China. Segmented financial information of the three business operating groups is set out below followed by a brief discussion of each business group.

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007 COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006

For The Three Months Ended September 30, 2007 In thousands of US Dollars	Group 1 Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3 Products (Telecom & Gaming) ($)	Group 4 Other Business ($)	TOTAL ($)
Revenues	3,971	470	5,305	56	9,802
Earnings / (Loss) from Operations	189	444	201	(697)	137

For The Three Months Ended September 30, 2006 In thousands of US Dollars	Group 1 Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3 Products (Telecom & Gaming) ($)	Group 4 Other Business ($)	TOTAL ($)
Revenues	3,733	40	6,411	341	10,525
Earnings / (Loss) from Operations	188	1	(191)	(616)	(618)

For The Nine Months Ended September 30, 2007 In thousands of US Dollars	Group 1 Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3 Products (Telecom & Gaming) ($)	Group 4 Other Business ($)	TOTAL ($)
Revenues	6,937	9,243	11,700	210	28,090
Earnings / (Loss) from Operations	830	793	1,824	(2,163)	1,284

For The Nine Months Ended September 30, 2006 In thousands of US Dollars	Group 1 Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3 Products (Telecom & Gaming) ($)	Group 4 Other Business ($)	TOTAL ($)

Revenues	10,312	106	18,262	3,758	32,332
Earnings / (Loss) from Operations	734	4	98	(584)	252

(1) Outsourcing services: Revenues for the three and nine months ended September 30, 2007 were $3,971,000 and $11,700,000, representing a year-over-year increase of 6% and 13% as compared to $3,733,000 and $10,312,000 for the same periods of last year. The increase was mainly derived from the inbound service, in-sourcing operations and telemarketing management, from which the sales revenues amounted to $635,000, $1,136,000 and $651,000 for the third quarter of this year, a quarter-over-quarter increase of 32%, 2% and 43%, respectively as compared to the same period of prior year. On the other hand, sales revenues from software business decreased to $518,000, a decrease of 24% as compared to $667,000 for the same period of prior year. Revenue from outsourcing services accounted for 41% of the Company's total revenues for the third quarter of FY2007.

(2) Telecom Value-added Services (VAS): Revenues for the three and nine months ended September 30, 2007 was $470,000 and $1,429,000 respectively, a significant year-over-year increase of 1,075% and 1,248% as compared to $40,000 and $106,000 for the same periods of last year. The increase was mainly due to the sales revenues from WAP based mobile phone games and traditional SP businesses, which accounted for 77% of the Company's total VAS revenues for the third quarter of FY2007.

(3) Products (Telecom & Gaming): Revenues for the three and nine months ended September 30, 2007 were $5,326,000, and $14,751,000, representing a year-over-year decrease of 17% and 19% as compared to $6,411,000 and $18,262,000 for the same periods of 2006, respectively. Decrease in Products revenues, which accounted for 54% of the Company's total revenues for the third quarter of FY2007, is largely due to contraction of the Company’s mobile phone wholesaling businesses in Greater China.

Gaming technology revenues derived from selling Multi-player Electronic Gaming Machine to casino operators amounted to $977,000, and accounted for 18% of total Products revenues for the third quarter of FY2007. With the internet gaming license granted by First Cagavan and Cagavan Economic Zone Authority (CEZA) of the Philippines, the company is widely recognized as a well positioned emerging gaming technology provider, both online and land-based. Moreover, successful penetration of the Cambodia gaming market brought some initial orders of 150 betting stations for the fourth quarter of 2007, plus further orders of 500-2000 betting stations in 2008.

Revenues from sales of Electronic Slot Machines amounted to $456,000, and accounted for 9% of the total Products Revenues for the third quarter of FY 2007, a sequential decrease of 64% as compared to the second quarter of FY2007. Decrease was largely due to allocation of precious technical resources to after-sale service of the deliveries made during the second quarter and work in progress of backlog orders from operators in Europe. The company continued to take advantage of the Italy's new Comma 6A gaming legislation in entering the largest European slot market, Italy, as an exclusive supplier of electronic slot machines to various leading gaming operators in Europe. Besides, our subsidiary, Take 1, has unveiled a new line of gaming machine products, Electronic Bingo Machines, at the Global Gaming Expo (G2E) Las Vegas, and received TST Certification for Gaming Accreditation.

As planned, the company continues to scale down its low-margin mobile phone wholesaling business and distribution business in Greater China. Revenues from sales of mobile phone for the three and nine months ended September 30, 2007, amounted to $3,893,00 and $9,903,000, a decline of 39% and 46% as compared to $6,411,000 and $18,262,000 for the same periods of 2006.

During the third quarter, the company's subsidiary - iMobile had signed a new agreement with Mototola (China) to become the latter's authorized distributor of MOTO accessory products for the MOTO Customer Service Network, MOTO Branded Stores and distribution channels in Southern China.

COST OF REVENUES

Cost of revenues for the three and nine months ended September 30, 2007 were $7,428,000 and $20,816,000, representing a decrease of 21% and 25% from $9,418,000 and $27,710,000 for the same periods last year, respectively. Cost of revenues as a percentage of the corresponding revenues was approximately 76% for the third quarter of FY2007 as compared to 89% for the same period of prior year.

(1) Outsourcing services: Cost of revenues from outsourcing services for the three and nine months ended September 30, 2007 amounted to $3,270,000 and $9,128,000, an increase of 9% and 14% respectively as compared with 2006. Increase in cost of revenues was largely due to headcount increase at service staff level.

(2) Telecom Value-added Services (VAS): Cost of revenues from VAS for the three and nine months ended September 30, 2007 was $161,000 and $475,000, an increase of 437% and 533% as compared with 2006. Increase is in line with sales growth of WAP-based mobile phone games.

(3) Products (Telecom & Gaming): Cost of revenues derived from Products for the three months ended September 30, 2007 amounted to $3,987,000 and $11,190,000, a reduction of 36% and 36% respectively, compared with the same periods of 2006. Approximately 92% of the cost of revenues related to Products for the third quarter of FY2007 was derived from the sales of mobile phones, and 8% was derived from the sales of electronic gaming machines.

GROSS PROFIT

Gross profit for the three and nine months ended September 30, 2007 was $2,374,000 and $7,274,000, a year-over-year increase of 114 % and 57%, respectively, as compared to $1,107,000 and $4,622,000 for the same periods of prior year. Gross margin was 24% and 26% for the three and nine months ended September 30, 2007 as compared to 11% and 12% for the same period of prior year, respectively. Quarterly improvement in gross margin was attributed to higher margin for Multiplayer Gaming Machines (57%) and Electronic Slot Machines (70%).

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses (SG&A) totaled $2,030,000 and $5,395,000 for the three and nine months ended September 30, 2007, an increase of 28% and an increase of 33% respectively as compared to $1,580,000 and $4,067,000 for the same periods of prior year. SG&A consists primarily of indirect staff salaries, office rental, insurance, advertising expenditures and traveling costs.

(1) Outsourcing services: SG&A attributed to outsourcing services for the three and nine months ended September 30, 2007 amounted to $480,000 and $1,671,000, a decrease of 5% and an increase of 13% as compared to $506,000 and $1,479,000 for the same periods of prior year.

(2) Telecom Value-added Services (VAS): SG&A attributed to VAS for the three and nine months ended September 30, 2007 amounted to negative $154,000 and $68,000, as compared to $9,000 and $27,000 for the same periods of prior year.

(3) Products (Telecom & Gaming): SG&A attributed to Products for the three and nine months ended September 30, 2007 amounted to $1,018,000 and $1,419,000, an increase of 422% and 191% as compared to $195,000 and $487,000 for the same periods of prior year. Increase in SG&A was primarily due to additional headcount and office expenses incurred by newly opened Zhuhai R&D center and Macau sales center, for sustained development of the gaming technology business growth.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (in thousands, except percentages)	Three months ended September 30, 2007 ($)	Three months ended September 30, 2006 ($)	Percentage Change (%)
Remuneration	1,004	690	45
Office	370	246	50
Travel	95	88	7
Entertainment	66	35	89
Professional (legal and consultant)	139	71	96
Audit	583	16	3,578
Selling	110	51	117
Recovery of provisions for doubtful accounts from subsequent collections	(424)	(28)	1,440
Other	88	98	(12)
Total	2,030	1,268	60

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (in thousands, except percentages)	Nine months ended September 30, 2007 ($)	Nine months ended September 30, 2006 ($)	Percentage Change (%)
Remuneration	3,222	1,908	69
Office	1,015	685	48
Travel	358	211	70
Entertainment	165	90	84
Professional (legal and consultant)	499	273	83
Audit	720	154	369
Selling	295	187	58
Recovery of doubtful accounts from subsequent collections	(1,115)	-	n/a
Other	236	251	-6
Total	5,395	3,757	44

INCOME / (LOSS) FROM OPERATIONS

On a year-over-year basis, income from operations amounted to $137,000 and $1,284,000 for the three and nine months ended September 30, 2007, as compared to ($618,000) and $252,000 for the same periods of prior year respectively.

Significant increase in operating income was mainly derived due to higher margin gaming revenues, which accounted for 7% of the total operating income for the third quarter of FY2007.

INCOME TAXES

The income tax provisions for the three and nine months ended September 30, 2007 were $46,000 and $0 as compared to ($40,000) and ($70,000) for the same periods of prior year. Interim income tax provisions are based upon management's estimate of taxable income and the resulting consolidated effective income tax rate for the full year. As a result, such interim estimates are subject to change as the year progresses and more information becomes available. We, however, expect our income taxes to increase as our net income increases and the tax holidays we have benefited from in Hong Kong and the PRC expire.

MINORITY INTERESTS

Minority interests for the three and nine months ended September 30, 2007 totaled $130,000 and $1,004,000 respectively as compared with $12,000 and $527,000 for the same period of prior year, representing minority ownership interests in subsidiaries consolidated in the Company's consolidated financial statement.

NET INCOME

On a year-over-year basis, Net Income amounted to ($220,000) and ($639,000) for the three and nine months ended September 30, 2007 respectively, as compared to ($1,115,000) and $604,000 for the same period of prior year. Quarterly Net Loss was directly associated with Loss on disposal, which amounted to $356,000 for the third quarter of FY 2007. However, as the company focused on the high-margin Gaming Technology Business, this year, Net Income from sales of Electronic Gaming Machines reached $35,000 and $190,000 respectively for the three and nine months ended September 30, 2007.

CASH

Net cash and cash equivalents at September 30, 2007 were approximately $4.9 million, an increase of approximately $3.0 million as compared to December 31, 2006. This was primarily due to successful collection of certain doubtful debts.

CONTRACTUAL OBLIGATIONS

Contractual obligations as of September 30, 2007 are detailed below:

Payments Due by Period

Contractual Obligations	Total	Less than 1 year	1-5 years	After 5 years
Line of credit	$ 181	$ 181	$	$
Bank Loans	2,819	768	670	1,381
Operating leases	758	603	155	-
Capital leases	152	90	62	-
Total cash contractual obligations	$ 3,910	$ 1,642	$ 887	$ 1,381

In addition to above, as previously disclosed in the paragraph under the sub-heading of PROBABLE EVENT OF DEFAULT under Item 1 - CONVERTIBLE DEBENTURES, the terms of the convertible note obligate the Company to pay monthly 2% of outstanding principal as liquidated damages and 30% of the outstanding principal as mandatory default amount from the date of ineffectiveness of registration statement. As of September 30, 2007, the Company has accrued three months of liquidated damages and mandatory default amount or approximately $2,697,000, although the Company may not have to pay the full amount of liquidated damages. The amount has been reflected in the consolidated financial statements as a separate line item on the consolidated balance sheet as “liquidated damages liability”.

OFF-BALANCE SHEET ARRANGEMENTS

We had no off-balance sheet guarantees, interest rate swap transactions or foreign currency forward contracts. We did not engage in trading activities involving non-exchange traded contracts during the third quarter of 2006.

There were no off-balance sheet guarantees, interest rate swap transactions, foreign currency forward contracts or long term purchase commitments outstanding as of September 30, 2007. Further, the Company had not engaged in any non-exchange trading activities during third quarter of 2007.

INFLATION

Inflation has not had a material impact on the Company's business in recent years.

CURRENCY EXCHANGE FLUCTUATIONS

All of the Company's revenues are denominated either in U.S. dollars or Hong Kong dollars, while its expenses are denominated primarily in Hong Kong dollars and Renminbi ("RMB"), the currency of the People's Republic of China. The value of the RMB-to-U.S. dollar or Hong Kong dollar-to-United States dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. Since 1994, the conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates on the world financial markets. Since 1994, the official exchange rate generally has been stable. Recently there has been increased political pressure on the Chinese government to decouple the RMB from the United States dollar. Although a devaluation of the Hong Kong dollar or RMB relative to the United States dollar would likely reduce the Company's expenses (as expressed in United States dollars), any material increase in the value of the Hong Kong dollar or RMB relative to the United States dollar would increase the Company's expenses, and could have a material adverse effect on the Company's business, financial condition and results of operations. The Company has never engaged in currency hedging operations and has no present intention to do so.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to various market risks arising from adverse changes in market rates and prices, such as foreign exchange fluctuations and interest rates, which could impact our results of operations and financial position. We do not currently engage in any hedging or other market risk management tools, and we do not enter into derivatives or other financial instruments for trading or speculative purposes.

Foreign Currency Exchange Rate Risk

Fluctuations in the rate of exchange between the U.S. dollar and foreign currencies, primarily the Hong Dollar and the Chinese Renminbi, could adversely affect our financial results. During the quarter ended September 30, 2006, approximately all of our sales are denominated in foreign currencies. We expect that foreign currencies will continue to represent a similarly significant percentage of our sales in the future. Selling, marketing and administrative costs related to these sales are largely denominated in the same respective currency, thereby mitigating our transaction risk exposure. We therefore believe that the risk of a significant impact on our operating income from foreign currency fluctuations is not substantial. However, for sales not denominated in U.S. dollars, if there is an increase in the rate at which a foreign currency is exchanged for U.S. dollars, it will require more of the foreign currency to equal a specified amount of U.S. dollars than before the rate increase. In such cases and if we price our products in the foreign currency, we will receive less in US. dollars than we did before the rate increase went into effect. If we price our products in U.S. dollars and competitors price their products in local currency, an increase in the relative strength of the U.S. dollar could result in our price not being competitive in a market where business is transacted in the local currency. All of our sales denominated in foreign currencies are denominated in the Hong Dollar and the Chinese Renminbi. Our principal exchange rate risk therefore exists between the U.S. dollar and these two currencies. Fluctuations from the beginning to the end of any given reporting period result in the re-measurement of our foreign currency-denominated receivables and payables, generating currency transaction gains or losses that impact our non-operating income/expense levels in the respective period and are reported in other (income) expense, net in our combined consolidated financial statements. We do not currently hedge our exposure to foreign currency exchange rate fluctuations. We may, however, hedge such exposure to foreign currency exchange rate fluctuations in the future.

All of our sales denominated in foreign currencies are denominated in the Hong Dollar and the Chinese Renminbi. Our principal exchange rate risk therefore exists between the U.S. dollar and these two currencies. Fluctuations from the beginning to the end of any given reporting period result in the re-measurement of our foreign currency-denominated receivables and payables, generating currency transaction gains or losses that impact our non-operating income/expense levels in the respective period and are reported in other (income) expense, net in our combined consolidated financial statements. We do not currently hedge our exposure to foreign currency exchange rate fluctuations. We may, however, hedge such exposure to foreign currency exchange rate fluctuations in the future.

Interest Rate Risk

Changes in interest rates may affect the interest paid (or earned) and therefore affect our cash flows and results of operations. We are exposed to interest rate change risk with respect to Epros' (one of our subsidiaries) credit facility with a commercial lender. However, we do not believe that this interest rate change risk is significant.

Inflation

Inflation has not had a material impact on the Company's business in recent years.

Currency Exchange Fluctuations

All of the Company's revenues are denominated either in U.S. dollars or Hong Kong dollars, while its expenses are denominated primarily in Hong Kong dollars and Chinese renminbi ("RMB"). The value of the RMB-to-U.S. dollar or Hong Kong dollar-to-United States dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. Since 1994, the conversion of renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's inter-bank foreign exchange market rates and current exchange rates on the world financial markets. Since 1994, the official exchange rate for the conversion of renminbi to U.S. dollars had generally been stable and the renminbi had appreciated slightly against the U.S. dollar. However, on July 21, 2005, the Chinese government changed its policy of pegging the value of Chinese renminbi to the U.S. dollar. Under the new policy, Chinese renminbi may fluctuate within a narrow and managed band against a basket of certain foreign currencies. Recently there has been increased political pressure on the Chinese government to decouple the renminbi from the United States dollar. At the recent quarterly regular meeting of People's Bank of China, its Currency Policy Committee affirmed the effects of the reform on Chinese renminbi exchange rate. Since February 2006, the new currency rate system has been operated; the currency rate of renminbi has become more flexible while basically maintaining stable and the expectation for a larger appreciation range is shrinking. Although a devaluation of the Hong Kong dollar or renminbi relative to the United States dollar would likely reduce the Company's expenses (as expressed in United States dollars), any material increase in the value of the Hong Kong dollar or renminbi relative to the United States dollar would increase the Company's expenses, and could have a material adverse effect on the Company's business, financial condition and results of operations. For fluctuations in period to period exchange rates, the translation adjustment is required to translate from local functional currency to the USD reporting currency (not RMB to HKD to USD). The Company has never engaged in currency hedging operations and has no present intention to do so.

Concentration of Credit Risk

Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted. Concentrations of credit risk (whether on or off balance sheet) that arise from financial instruments exist for groups of customers or counterparties when they have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions as described below:

- The Company's business is characterized by rapid technological change, new product and service development, and evolving industry standards and regulations. Inherent in the Company's business are various risks and uncertainties, including the impact from the volatility of the stock market, limited operating history, uncertain profitability and the ability to raise additional capital.

- All of the Company's revenue is derived from Asia and Greater China. Changes in laws and regulations, or their interpretation, or the imposition of confiscatory taxation, restrictions on currency conversion, devaluations of currency or the nationalization or other expropriation of private enterprises could have a material adverse effect on our business, results of operations and financial condition.

- If the Company is unable to derive any revenues from Greater China, it would have a significant, financially disruptive effect on the normal operations of the Company.

* A substantial portion of the operations of business operations depend on mobile telecommunications operators (operators) in China and any loss or deterioration of such relationship may result in severe disruptions to their business operations and the loss of a significant portion of the Company's revenue. The VIEs rely entirely on the networks and gateways of these operators to provide its wireless value-added services. Specifically these operators are the only entities in China that have platforms for wireless value-added services. The Company's agreements with these operators are generally for a period of less than one year and generally do not have automatic renewal provisions. If neither of them is willing to continue to cooperate with the Company, it would severely affect the Company's ability to conduct its existing wireless value-added services business.

Seasonality and Quarterly Fluctuations

Several of our businesses experience fluctuations in quarterly performance. Traditionally, the first quarter from January to March is a low season for our call center business due to the long Lunar New Year holidays in China Revenues and income from gaming products, call center and telecom value-added services tend to be higher in the fourth quarter due to special holiday promotions. Internet/Direct Commerce revenues also tend to be higher in the fourth quarter due to increased consumer spending during that period. Revenues from the gaming and VAS can vary from quarter to quarter due to new product launches and the seasonality of certain product lines

Sales of our gaming machines to Macau and other Asian casinos and gaming operators are generally strongest in Q3 and Q4 and slowest in the Chinese New Year holiday season in Q1. In addition, quarterly revenues and net income may increase when we receive a larger number of approvals for new games from regulators and gaming operators than in other quarters, when a game or platform that achieves significant player appeal is introduced or if gaming is permitted in a significant new jurisdiction. In addition, as further technology advancements become available for the gaming industry, replacement or conversion of gaming machines will be impacted once any such advanced technology is approved by regulators.

ITEM 4. CONTROLS AND PROCEDURES

We maintain controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Certain internal audit tests performed at the fiscal year-end of 2006 revealed that there were weaknesses inherent in the Company's internal control system. Among which it was noted that there were insufficient checks and balances in place for controlling the company's non-routine transactions, namely: accuracy and completeness of stock option expense calculation. Such weaknesses in our controls eventually led to prior period option expense restatements being charged to the Company's financial statements for the years ended December 31, 2003, 2004, and 2005 respectively. As a result, our chief executive officer and our former chief financial officer concluded that there was a material weakness in our disclosure controls and procedures.

As of the end of the quarter covered by this report, the company had taken various steps to maintain the accuracy of our financial disclosures, and improve company internal control. An internal control SOX implementation team led by senior managers had been set up to uncover potential significant deficiencies inherent in the internal control systems of the company, including but not limited to risk identification, control procedure setup, staff training, segregation of incompatible job duties, design of management reporting system, definition and delegation of signing authority, establishment of documentation system and implementation of a company-wide SOX compliant ERP system. Based on the current schedule, the Company is expected to be substantially SOX compliant by the end of FY2007.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

In July 2007, the Company failed to timely make scheduled principal payments under an Amended and Restated Variable Rate Convertible Debenture due March 2009 (the "Amended Debenture") in the aggregate amount of $8,000,000. Pursuant to the terms of the Amended Debenture, the Company was obligated to make monthly redemption payments commencing on January 1, 2007, until the Amended Debenture was redeemed in full. On August 1, 2007, the Company made the July monthly redemption and interest payments to all of the debenture holders.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

The following exhibits are filed as part of this report:

EXHIBIT NUMBER	DESCRIPTION
31.1	Rule 13a-14(a) Certification of Chief Executive Officer (Principal Executive Officer)
31.2	Rule 13a-14(a) Certification of Chief Financial Officer (Principal Financial Officer)
32.1	18 U.S.C. Section 1350 Certifications

33

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PACIFICNET INC.

Date: November 27, 2007	By:	/s/ Tony Tong Tony Tong Chief Executive Officer (Principal Executive Officer)
Date: November 27, 2007	By:	/s/ Daniel Lui Daniel Lui Chief Financial Officer (Principal Financial Officer)