PACIFICNET INC
Form 10-Q/A
December 11, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q/A
(Amendment No. 1)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007

o 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 (State or other jurisdiction of incorporation or organization)	**91-2118007** (I.R.S. Employer Identification Number)
23/F, TOWER A, TIMECOURT, NO.6 SHUGUANG XILI, CHAOYANG DISTRICT, BEIJING, CHINA 100028 (Address of principal executive offices)	**N/A** (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 May 30, 2007, there were 11,782,072 shares of the issuer's common stock, par value $0.0001 per share, outstanding.

EXPLANATORY NOTE:

This Quarterly Report on Form 10-Q/A ("Form 10-Q/A") is being filed as Amendment No. 1 to our Quarterly Report on Form 10-Q for the period ended March 31, 2007, which was originally filed with the Securities and Exchange Commission ("SEC") on May 31, 2007. We are amending and restating the following specific items in this Form 10-Q/A:

1. Part I. Item 1. Financial Statements - to restate the financial statements as of, and for the three months ended March 31, 2007, and to restate the balance sheet as of December 31, 2006;
2. Part I. Item 2. Management's Discussion And Analysis of Financial Condition and Results of Operations.
3. Part II. Item 6 - to update the officer certifications for this Form 10-Q/A.

PACIFICNET INC.
Form 10-Q/A for the Quarterly Period Ended March 31, 2007

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

	March 31, 2007 Unaudited Restated	December 31, 2006 Audited Restated
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,041	$ 1,900
Restricted cash - pledged bank deposit	235	234
Accounts receivables, net	8,411	8,141
Inventories	428	201
Loan receivable from related parties	713	1,706
Loan receivable from third parties	178	128
Marketable equity securities - available for sale	568	558
Loans to employees	1,341	770
Other receivables, net	290	170
Other current assets	2,796	3,233
Total Current Assets	19,001	17,041
Property and equipment, net	6,656	4,711
Investments in affiliated companies and subsidiaries	34	1,257
Intangible assets, net	400	323
Goodwill	6,258	5,601
Other assets	-	471
Net assets held for disposition	8,876	7,522
TOTAL ASSETS	$ 41,225	$ 36,926
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Bank line of Credit	$ 404	$ 855
Bank loans-current portion	933	576
Capital lease obligations - current portion	110	120
Accounts payable	1,277	1,266
Accrued expenses and other payables	1,711	1,828
Customer deposits	341	352
Loans payable to related party	577	638
Convertible debenture	7,854	8,945
Warrant liability	844	904
Liquidated damages liability	2,697	2,837
Total Current Liabilities	16,748	18,321
Long-term liabilities:		
Bank loans - non current portion	2,280	1,635
Capital lease obligations - non current portion	104	124
Convertible Debenture- non current portion, net	2,307	-
Total long-term liabilities	4,691	1,759

Total liabilities	21,439	20,080
Minority interest in consolidated subsidiaries	4,206	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: March 31, 2007: 14,355,041 shares issued, 11,782,072 outstanding December 31, 2006: 14,155,597 issued, 11,538,664 outstanding	1	1
Treasury stock, at cost (2007 Q1: 2,572,969 shares, 2006: 2,616,933 shares)	(145)	(272)
Additional paid-in capital	67,003	65,757
Cumulative other comprehensive income (loss)	(13)	(42)
Accumulated deficit	(50,782)	(51,090)
Less: stock subscription receivable	(484)	(377)
Total Stockholders' Equity	15,580	13,977
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 41,225	$ 36,926

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

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

	Three months ended March 31	
	2007 Unaudited Restated	**2006 Unaudited Restated**
Net Revenues		
Services	$ 4,565	$ 3,736
Product sales	4,702	2,936
Total Net Revenues	9,267	6,672
Cost of revenues		
Services	3,353	2,577
Product sales	3,375	2,743
Total Cost of Revenues	6,728	5,320
Gross Profit	2,539	1,352
Selling, general and administrative expenses	1,567	1,079
Stock-based compensation expenses	-	182
Depreciation and amortization	172	29
Total Operating Expenses	1,739	1,290
INCOME(LOSS) FROM OPERATIONS	800	62
Other Income (Expenses):		
Interest income (Expenses), net	(200)	(52)
Gain (Loss) in change in fair value of derivatives	61	-
Sundry income, net	19	15
Total Other Income (Expenses)	(120)	(37)
Income (Loss) before Income Taxes and Minority Interest	680	25
Provision for income taxes	(68)	(17)
Share of earnings of associated companies	-	(3)
Minority interests	(534)	(86)
Income (Loss) from Continued Operations	78	(81)
Income from discontinued operations	230	882
Net Income	308	801
Other comprehensive item:		
Foreign exchange gain (loss)	29	(20)
Net Comprehensive Income	$ 337	$ 781
Basic Earnings (Loss) per share-Continued Operations	$ 0.01	$ (0.01)
Basic Earnings per share-Discontinued Operations	$ 0.02	$ 0.08
Basic Earnings per share	$ 0.03	$ 0.07

Diluted Earnings (Loss) per share-Continued Operations	$	0.01	$	(0.01)
Diluted Earnings per share-Discontinued Operations	$	0.02	$	0.08
Diluted Earnings per share	$	0.03	$	0.07
Weighted average number of shares - Basic		11,703,376		10,834,299
Weighted average number of shares - Diluted		11,997,317		10,834,299

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

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PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited. In thousands of United States dollars)

	FOR THE THREE MONTH PERIODS ENDED	
	2007 Unaudited Restated	2006 Unaudited Restated
Cash Flows from operating activities		
Net income	$ 308	$ 801
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity loss of associated companies	-	3
Provision for allowance for doubtful accounts	(378)	-
Minority Interest	534	86
Unrealized losses/(gain) on marketable equity securities	-	(2)
Depreciation and amortization	306	29
(Gain) loss from discontinued operations	(230)	-
Stock-based compensation	-	182
Change in fair value of derivatives	(61)	-
Changes in current assets and liabilities net of effects from purchase of subsidiaries:		
Accounts receivable and other current assets	(573)	(6,310)
Inventories	(227)	76
Accounts payable and other accrued expenses	294	2,527
Net cash used in operating activities of continued operations	(27)	(2,608)
Net provided by operating activities of discontinued operations	872	4,756
Net cash provided by operating activities	845	2,148
Cash flows from investing activities:		
Decrease in restricted cash	(1)	(1,490)
Increase in purchase of marketable securities	(10)	(24)
Acquisition of property and equipment	(819)	(3,794)
Acquisition of subsidiaries and affiliated companies	88	(4)
Loans receivable from third parties	(50)	-
Loans receivable from related party	(33)	(246)
Net cash used in investing activities of continued operations	(825)	(5,558)
Net cash provided by investing activities of discontinued operations	-	-
Net cash used in investing activities	(825)	(5,558)
Cash flows from financing activities:		
Decrease in loan receivables	-	(43)
Loan payable to related party	(61)	(723)
Stock subscription receivable	-	(13)
Repayments under bank line of credit	(451)	(48)
Repayments of amount borrowed under capital lease obligations	(30)	(34)
(Purchase) sale of treasury shares	127	-
Proceeds from subscription received, exercise of stock options and warrants	-	42
Net proceeds from issuance of convertible debenture	2,290	8,000
Advances under bank loans	217	1,792

Net cash provided by financing activities of continued operations		2,092		8,973
Net cash provided by financing activities of discontinued operations		-		-
Net cash provided by financing activities		2,092		8,973
Effect of exchange rate change on cash and cash equivalents		29		-
NET INCREASE IN CASH AND CASH EQUIVALENTS		2,141		5,563
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD		1,900		3,486
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	$	4,041	$	9,049
CASH PAID FOR:				
Interest	$	221	$	87
Income taxes	$	-	$	32
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Proceed from option exercised for shares receivable	$	-	$	35
Property & equipment acquired under banking loan	$	785	$	-
Investments in subsidiaries acquired through the issuance of common stock	$	-	$	397

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

PACIFICNET INC. AND SUBSIDIARIES
NOTES TO UNAUDITED 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 prior period amounts have been reclassified to conform to the current period presentation.

Going Concern

As shown in the accompanying consolidated financial statements, the Company incurred accumulated losses of $50.8 million and $51.1 million as of March 31, 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 17).

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 17).

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2. RECENT 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 (Novell's fiscal 2008), 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 first 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 March 31, 2007 exclude the potential dilutive effect of 889,456 warrants because their impact would be anti-dilutive based on current market prices. 690,909 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:

	Three Months Ended March 31,	
(IN THOUSANDS OF UNITED STATES DOLLARS, EXCEPT WEIGHTED SHARES AND PER SHARE AMOUNTS)	**2007**	**2006**
Numerator: Net Income	$ 308	$ 801
Denominator:		
Weighted-average shares used to compute basic EPS	11,703,376	10,834,299
Weighted-average shares used to compute diluted EPS	11,997,317	10,834,299
Basic earnings per common share:	$ 0.03	$ 0.07
Diluted earnings per common share:	$ 0.03	$ 0.07

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4. OTHER CURRENT ASSETS

Other current assets consist of the following (in thousands):

	March 31, 2007 Unaudited Restated	December 31, 2006 Audited Restated
Prepayment	$ 725	$ 1,048
Utilities deposit	1,326	1,292
Receivable from Lion Zone Holdings Ltd	385	485
Prepaid expenses	360	408
Total	$ 2,796	$ 3,233

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 Restated
Balance as of December 31, 2006	$ 3,964	$ 461	$1,176	$5,601
Goodwill acquired during this quarter	-	-	657	657
Balance as of March 31, 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 12).

6. ACCRUED EXPENSES & OTHER PAYABLES

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

(in thousands of US Dollars):	2007 Unaudited Restated	2006 Audited Restated
Professional fee	$ 695	$ 321
Director fee	88	100
Salaries and benefit payable	156	792
Marketing expense	588	389
Others	184	226
Total	$ 1,711	$ 1,828

7. STOCKHOLDERS' EQUITY

a) COMMON STOCK

For the three month period ended March 31, 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.

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 three months ended March 31, 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 March 31, 2007, is as follows:

	OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE
OUTSTANDING, DECEMBER 31, 2005	**756,100**	$ 3.99
Granted	500,000	$ 4.75
Cancelled	(491,600)	$ 4.75
Exercised	(394,000)	$ 2.12
OUTSTANDING, DECEMBER 31, 2006	**370,500**	$ 2.00
Granted	**-**	-
Cancelled	**-**	-
Exercised	**-**	-
OUTSTANDING MARCH 31, 2007	**370,500**	$ 2.00

Following is a summary of the status of options outstanding at March 31, 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
2004-7-26	370,500	$1,237,470	0.32	$2.00	370,500	$2.00

The 370,500 outstanding options, which granted during year 2004, will be expired at July 26 of 2007. Those options were vested from July 1st of 2005 with 10 months vesting period, and the corresponding compensation cost have been recorded within the vesting period. The weighted-average fair value of such options was $1.41.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	2.75%

Expected life of the options	1.65 years
Expected volatility	61.33%
Expected dividend yield	0%

No options were granted, cancelled and exercised during the three month period ended March 31, 2007.

c) WARRANTS

At March 31, 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 3.09 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**	$ 9.50	$ -
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	$ -

Following is a summary of the status of warrants outstanding at March 31, 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	1.79	$7.15	123,456	$7.15
2004-11-15	117,682	2.63	$3.89	117,682	$3.89
2004-12-9	350,000	2.69	$12.21	350,000	$12.21
2006-3-13	416,000	3.95	$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 quarter ended March 31 of 2007.

d) TREASURY STOCK

The following is a summary of the movement of the Company's shares held as treasury stock as at March 31 of 2007:

	Number of shares
Escrow shares returned to treasury in 2003	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 (1)	529,848
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, March 31, 2007	2,572,969
Shares outstanding at March 31, 2007	11,782,072
Shares issued at March 31, 2007	14,355,041

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

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

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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 six month 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 March 31, 2007 is $6,909,086.

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 $60,694 representing the change in fair value of warrants was recognized during the three months ended March 31, 2007.

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 can 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 remaining principal amount of the Debenture of $6,909,086 and the principal amount of the new Debentures of $945,000 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)		March 31, 2007
Liquidated damages	2%	$450
Mandatory default	30%	2,247
Total		$2,697

Such amounts have been recorded as liquidated damages liability as of March 31, 2007.

The Company issued 199,444 shares to redeem $1,090,909 of convertible note as of March 31, 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% to 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. PacGames received the first payment of $2.5 million during the first quarter of 2007.

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 March 31, 2007 amounted to $29,041.

Following is the summary of convertible debenture:

($,000)		March 31, 2007
Convertible debenture	$	2,500
Unamortized financing cost		(193)
	$	2,307

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 ChinaGoHi (discontinued), Linkhead (discontinued), Clickcom (discontinued) and Guangzhou 3G/Sunroom. 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, 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 March 31, 2007	Group 1.	Group 2.	Group 3.	Group 4.	Total
(in thousands, except percentages)	Outsourcing Services	Telecom Value-Added Services	Products (Telecom & Gaming)	Other Business	(Restated)

	($)	($)	($)	($)	($)
Revenues	3,963	527	4,773	4	9,267
(% of Total Revenues)	43%	6%	52%		100%
Income / (Loss) from Operations	400	(3)	1,196	(793)	800
(% of Total Profit)	50%		150%	(99)%	100%
Total Assets	8,322	(2,140)	15,875	19,168	41,225
(% of Total Assets)	20%	(5)%	39%	46%	100%
Goodwill	3,964	461	1,833		6,258
Geographic Area	HK, PRC	HK, PRC	HK, PRC, Macau	HK,PRC	

For the three months ended March 31, 2006	Group 1.	Group 2.	Group 3.	Group 4.	Total
(in thousands, except percentages)	Outsourcing Services	Telecom Value-Added Services	Products (Telecom & Gaming)	Other Business	(Restated)
	($)	($)	($)	($)	($)
Revenues	3,022	295	3,355		6,672
(% of Total Revenues)	45%	4%	50%		100%
Income / (Loss) from Operations	206	15	359	(518)	62
% of Total Profit)	332%	24%	579%	(835)%	100%
Total Assets	12,088	15,011	6,089	13,221	46,409
(% of Total Assets)	26%	32%	13%	28%	100%
Goodwill	3,964				3,964
Geographic Area	HK,PRC	HK,PRC	HK,PRC, Macau	HK,PRC	

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

For the three months ended March 31, 2007	Hong Kong, Macau	PRC	United States	Total (Restated)
Product revenues	2,137	1,550	1,015	4,702
Service revenues	3,492	1,073	-	4,565

For the three months ended March 31, 2006	Hong Kong, Macau	PRC	United States	Total (Restated)
Product revenues	2,936	-	-	2,936
Service revenues	3,027	709	-	3,736

10. RELATED PARTY TRANSACTIONS

LEASE AGREEMENT

In November 2004, the Company entered into a lease agreement with EPRO for rental space in the amount of $1,923 per month. The term of the lease was one year and renewable by either party.

LOAN DUE FROM RELATED PARTIES

At March 31, 2007, there was a total loan receivable of approximately $713,000 due from related parties. Included in which were $279,000 from MOABC, an affiliated company that is 15% owned by PacificNet, and $434,000 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 $254,000 due from a shareholder of Yueshen, $64,000 due from a director of Soluteck and $116,000 due from a director of PACT Communications. Terms of these related parties loan receivables and payables are summarized below:

LOAN TO MOABC

MOABC is an affiliated company, 15% owned by PacificNet, as of March 31, 2007. A convertible loan of $279,000 is outstanding from MOABC as of March 31, 2007. Terms of the convertible loan provide PacificNet an option at any time during the term of the loan to convert in part or in whole of the then outstanding loan principle into equity interest of MOABC, at $23,160 for each 1% of MOABC shares.

LOAN TO YUESHEN'S SHAREHOLDER

As of March 31, 2007, there was a loan outstanding of $254,000 receivable from the shareholder of Yueshen. This loan is secured by 106,240 PacificNet shares. Further discussion of the Company's legal dispute with Yueshen can be found under Part II of this 10Q document - Item1: Legal Proceedings.

LOAN TO SOLUTECK'S DIRECTOR

As of March 31, 2007, there was a loan outstanding of $64,000 receivable from a director of Soluteck, due on December 14 for three consecutive years ending 2007. 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 March 31, 2007, there was a loan outstanding of $116,000 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.

LOAN DUE TO RELATED PARTIES

As of March 31, 2007, there was an outstanding loan payable of $577,000 due to related parties. Included in which was a loan payable of $292,000 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 March 31, 2007, a loan of $285,000 was payable to a shareholder of Smartime. The loan was advanced to Smartime by a shareholder of Smartime on behalf of the Company for working capital purposes.

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 Q1 amounted to $152,000 (2006 Q1: $128,000). Future minimum lease payments under non-cancelable operating leases are $655,000 for the period from January 2007 to December 2008 and $684,000 for the period from January 2008 to December 2011, respectively.

RESTRICTED CASH - Term deposit of $235,000 has been pledged to certain financial institutions for bank line overdraft protection of Epro.

BANK LINE OF CREDIT - As of March 31, 2007, the Company's outstanding bank line of credit were as follows:

(i) Epro has an overdraft banking facility of up to $294,000 with certain banking institutions, which is secured by a pledge of its fixed deposits of $235,000. 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 $110,000 with a Hong Kong banking institution. This overdraft facility is secured by a personal deposit account of a director of Smartime.

BANK LOANS - Tabulated below are bank loans outstanding (in thousands):

	March 31, 2007	**December 31, 2006**
	Unaudited	Audited

	Restated	Restated
Secured [1]	$ 2,476	$ 1,668
Unsecured	737	543
Current portion	(933)	(576)
Non current portion	$ 2,280	$ 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; second legal charge over a property owned by a subsidiary of the Company; and pledged bank deposits of $235,000 (2006: $234,000) of a subsidiary of the Company.

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Aggregate future maturities of borrowing for the next five years are as follows (in thousands of US Dollars):

	April 2007 to March 2008	April 2008 to March 2009	April 2009 to March 2010	April 2010 to March 2011	April 2011 to March 2012	Thereafter	TOTAL
Beijing PACT office mortgage (1)	$ 51	$ 54	$ 57	$ 43	$ 81	$ 761	$ 1,047
Shenzhen PACT office mortgage (2)	21	23	24	26	28	648	770
Sub-total	72	77	81	69	109	1,409	1,817
Bank loans (3)	437	404	131	-	-	-	972
AR factoring loans (3)	424	-	-	-	-	-	424
Sub-total	861	404	131	-	-	-	1,396
TOTAL	$ 933	$ 481	$ 212	$ 69	$ 109	$ 1,409	$ 3,213

(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%.

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 three years are as follows: 2007: \$110,000; 2008: \$80,000; 2009:\$24,000, and thereafter: none.

	Aggregate future lease payments
2007	$ 110,000
2008	80,000
2009	24,000
Thereafter	-
Total	224,000
Current portion	(110,000)
Non-current portion	$ 104,000

12. 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:	
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 March 31, 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 profit of US$128,205 for the quarter ended March 31, 2007 is available. Accordingly, the contingent consideration of 149,459 shares has not been reflected in the consolidated financial statements of the Company as of March 31, 2007.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE QUARTER ENDED MARCH 31, 2007 AND 2006

The following is an un-audited pro forma consolidated financial information for the quarter ended March 31, 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.

	Three months ended September 30	
(un-audited and in thousands of U.S. dollars)	2007	2006
Revenue	$ 9,267	$ 6,916
Operating income	$ 800	$ 47
Net profit	$ 308	$ 796
Earnings per share – basic	$ 0.03	$ 0.07
Earnings per share – diluted	$ 0.03	$ 0.07

Accordingly, PacificNet included the financial results of Take 1 in its consolidated 2007 financial results from January 5, 2007 through March 31, 2007.

13. INVESTMENTS IN AFFILIATED COMPANIES

Investments in affiliated companies consists of the following as of March 31, 2007:

(US$ thousands)	COLLATERAL/OWNERSHIP % AND BUSINESS DESCRIPTION	
	AMOUNT	DESCRIPTION
INVESTMENTS IN AFFILIATED COMPANIES:		
Glad Smart	$30	15% ownership interest
Community media co.	$4	5% ownership interest
Total	$ 34	

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14. 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.

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 13, 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 case is now in the discovery stage before 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 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. 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.

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 argue that: (i) they had carried out the works according to the Contract terms; (ii) the works had been approved by PKL Consultants Limited, the consultant representative of the Employer; and (iii) a sum of HK$30,000 is still due and owing by PacificNet Power to JCHKL.

The case is now in the discovery stage before 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.

15. RESTATEMENT

On March 19, 2007 our predecessor auditor withdrew their opinion on our previously filed financial statements for the years ended December 31, 2005 and 2004 due to uncertainties around certain option grants during the said period. An independent investigation in this connection has been performed by our Audit Committee to address this matter.

In its May 3, 2007 Report, the Audit Committee concluded that, "…the Audit Committee did indeed find that, although the number and terms of option grants were being fixed by the Compensation Committee who deferred to the Board merely for a secondary review approval; whereby the Board of Directors still maintained the authority to cancel a prerequisite grant consummated by the Compensation Committee, therefore that Grant could likely be interpreted only as final at the date of approval of the company's Board of Directors. Hence, with this approach which seems to be more aligned with the SEC interpretation, financial restatement would be required to account for the granting of options that were "in the money" due to procedural administrative delay and the difference in the Compensation Committee grant date and the Board of Directors approval date. Accordingly, the Audit Committee recommended to the Board of Directors of Pacificnet, Inc. to charge additional stock based compensation expense to the company's financial statements for the fiscal years ended December 31, 2003, 2004 and 2005 respectively..."

Based on the Audit Committee Recommendations, extra stock-based compensation charges of approximately $0.3 million, $1.2 million and $0.1 million were charged to each of the years ended December 31, 2005, 2004 and 2003, respectively. Also, for the years ended December 31, 2005 and 2004, the Company determined that its allowance for bad debts on the accounts receivable was understated by $3.5 Million and $0.28 million in the years ended December 31, 2005 and 2006, respectively. The Company also restated impairment of goodwill for certain subsidiaries ($3.7 million and $2.6 million in the years ended December 31, 2005 and 2004, respectively) and accrued certain 2005 bonus payable in 2006 amounting to $600,000. Also, the Company concluded that the consolidation of certain entity (Yueshen) was wrongly reflected as the Company did not have control over the management of the entity.

Following the reaudit of its financial statements for the years ended December 31, 2005 and 2004, the Company restated its financials statements for the year ended December 31, 2006.

In the course of the financial statements restatement for the year ended December 31, 2006, management has decreased total non-current assets by $1 million worth of goodwill as a result of the re-audit restatement to the ending goodwill balances as at December 31, 2005. Further, management has also decreased total selling, general and administrative expenses by an aggregate of $6.3 million. Said decrease comprises of extra goodwill impairment amounting to approximately $3.7 million and $2.6 million, respectively, already charged to the restated Selling, General and Administrative expenses for the years ended December 31, 2005 and 2004. An impairment of investment of $1.2 million was also recorded for the year ended December 31, 2006 for an entity disposed in 2006.

Following the restatements of its financials statements for the years ended December 31, 2006, December 31, 2005 and December 31, 2004 the Company is restating its first quarter review for the year 2007 to account for the effects of its prior year's restatements.

Following are the effects of the restatement on the period ended March 31, 2007 and the year ended December 31, 2006:

	Three Months ended March 31, 2007		Year ended December 31, 2006	
Consolidated Balance Sheets:	As reported	As restated	As reported	As restated
ASSETS:				
Current assets	$ 19,126	$ 19,001	$ 17,041	$ 17,041
Non-current assets	26,285	22,224	24,841	19,885

Total assets	$ 45,411	$ 41,225	$ 41,882	$ 36,926
LIABILITIES				
Current liabilities	$ 14,959	$ 16,748	$ 17,376	$ 18,321
Non-current liabilities	6,480	4,691	2,704	1,759
Total liabilities	21,439	21,439	20,080	20,080
Minority interest	7,126	4,206	6,874	2,869
STOCKHOLDERS' EQUITY				
Common stock	1	1	1	1
Treasury stock	(130)	(145)	(257)	(272)
Additional paid-in capital	64,560	67,003	63,124	65,757
Cumulative other comprehensive income (loss)	249	(13)	220	(42)
Accumulated deficit	(47,431)	(50,782)	(47,739)	(51,090)
Stock subscription receivable	(403)	(484)	(421)	(377)
TOTAL STOCKHOLDERS' EQUITY	16,846	15,580	14,928	13,977
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 45,411	$ 41,225	$ 41,882	$ 36,926

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	Three Months ended March 31, 2007		Three Months ended March 31, 2006	
	As reported	As restated	As reported	As restated
Consolidated Statements of Operations:				
Net revenue	$ 9,267	$ 9,267	$ 6,672	$ 6,672
Cost of sales	(6,728)	(6,728)	(5,320)	(5,320)
Gross profit	2,539	2,539	1,352	1,352
Selling, General and Administrative expenses	(1,567)	(1,567)	1,079	1,079
Stock-based compensation expenses	-	-	(182)	(182)
Income from operations	800	800	62	62
Income before income taxes, minority interest and discontinued operations	680	680	25	25
Income/(loss) before discontinued operations	78	78	(81)	(81)
Income from discontinued operations	230	230	882	882
Net income available to common stockholders	$ 308	$ 308	$ 801	$ 801
Earnings per common share:				
Basic	$ 0.03	$ 0.03	$ 0.07	$ 0.07
Diluted	$ 0.03	$ 0.03	$ 0.07	$ 0.07
Shares used in computing earnings per share:				
Basic	11,719,168	11,703,376	10,855,761	10,834,299
Diluted	12,013,109	11,997,317	11,526,945	10,834,299
Consolidated Statements of Cash Flows				
Net income	$ 308	$ 308	$ 801	4801
Stock-based compensation	-	-	182	182
Net cash provided by (used in) operating activities	(100)	845	(157)	2,148
Net cash used in investing activities	(913)	(825)	(2,190)	(5,558)
Net cash provided by financing activities	2,271	2,092	7,619	8,973
Effect of exchange rate on cash & cash equivalent	29	29	18	-
NET INCREASE IN CASH AND CASH EQUIVALENTS	$ 4,041	$ 4,041	$ 3,778	$ 5,563

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

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.

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.

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 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 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.

Information relating to the operations of the subsidiaries up to the periods of disposal during the three month period ended March 31, 2007 is as follows (in thousands of US Dollars):

Linkhead	Power	Clickcom	PacTelso	Solutions	MOABC	3G	Total
(8)	-	(1)	-	1	(23)	261	230

Income(loss) from discontinued operations								
Net assets held for disposition	1,134	-	812	-	1	(42)	6,971	8,876

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..

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.

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 in the pleadings stage. We are unable to predict the outcome of these actions, or a reasonable estimate of the range of possible loss, if any.

Pacificnet Inc. vs Iroquois Master Fund, Ltd.

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 DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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/A (Amendment No.1) FOR THE YEAR ENDED DECEMBER 31, 2006 .

PRELIMINARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained in this Form 10-Q/A 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 of Financial Condition and Results of Operations." 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 months ended March 31, 2007 were amounted to $9,267,000, which represented a quarter-over-quarter increase of 39% as compared to $6,672,000 for the three months ended March 31, 2006. The increase in revenues was mainly due to the Products (Telecom & Gaming), primarily driven by the Company's high growth gaming technology businesses, and organic growth in Outsourcing Services Group, which posted a quarter-over-quarter increase of 42.3% and 31.1% respectively. The revenues in services and product sales during the first quarter of 2007 increased by 60.1% and 22.2% compared to the same periods of 2006. Segmented financial information of the three business operating groups is set out below followed by a brief discussion of each business group.

THREE MONTHS ENDED MARCH 31, 2007 COMPARED TO THREE MONTHS ENDED MARCH 31, 2006

For The Three Months Ended March 31, 2007	Group 1	Group 2. Telecom	Group 3	Group 4	
	Outsourcing	Value-Added	Products	Other	TOTAL
In thousands of US Dollars	Services	Services	(Telecom & Gaming)	Business	
	($)	($)	($)	($)	($)
Revenues	3,963	527	4,773	4	9,267
Earnings / (Loss) from Operations	400	(3)	1,196	(793)	800

For The Three Months Ended March 31, 2006	Group 1	Group 2. Telecom	Group 3	Group 4	
	Outsourcing	Value-Added	Products	Other	TOTAL
In thousands of US Dollars	Services	Services	(Telecom & Gaming)	Business	
	($)	($)	($)	($)	($)
Revenues	3,022	295	3,355	-	6,672
Earnings / (Loss) from Operations	206	15	359	(518)	62

(1) Outsourcing services: The quarter-over-quarter increase of 31.1% in outsourcing services for the three months ended March 31, 2007 was primarily due to the growth in outsourcing contact center in Hong Kong. Pricing was highly competitive but demand for outbound calling lists, in-sourcing operators and sub-contract call center facilities management, for American Express and MetLife, remained strong. Outsourcing revenues made up 42.8% of the Company's total revenues for the first quarter of the year.

(2) Telecom Value-added Services (VAS): Revenue for the three months ended March 31, 2007 was $527,000, a quarter-over-quarter increase of 78.6% as compare to the same period of 2006. VAS revenues made up 5.7% of the Company's total revenues for the first quarter of the year.

(3) Products (Telecom & Gaming): Revenue for the three months ended March 31, 2007 was $4,773,000, a quarter-over-quarter increase of 42.3% as compare to the same period of 2006. Products revenues made up 51.5% of the Company's total revenues for the first quarter of the year. During the quarter, the Company’s mobile phone distribution business in Greater China remained steady. The Company owned one of the largest on-line mobile phone distribution portals in China and was one of the top five largest mobile phone wholesalers in Hong Kong. Increase is primarily due to buildup of revenues derived from the Company’s emerging gaming technology businesses. Significant traction has been gained from continued winning of high profile gaming orders from the fast growing Asian gaming technology provider market. Company managed to continue build up excellent relationships with leading casino operators in Macau and the rest of Asia with its world class multi-player electronic table game machines customized to the taste of Asian gaming customers. In addition, winning the bid of providing electronic slot machines to various leading gaming operators’ slot halls in Europe also pushed revenues during the quarter.

COST OF REVENUES

Cost of revenues for the three months ended March 31, 2007 was $6,728,000, an increase of 26% from $5,320,000 for the three months ended March 31, 2006, respectively. The cost of revenues in services sales and product sales for the three months ended March 31, 2007 increased by 30% and 23%, respectively, in each case compared with the respective period in 2006. The increase in cost of revenues lagged behind the corresponding increase in revenues, which amounted to approximately 39%. Cost of revenues savings were primarily due to the contribution from higher margin gaming technology businesses.

GROSS PROFIT

Gross profit for the three months ended March 31, 2007 was $2,539,000, a significant increase of 88% as compared to $1,352,000 for the three months ended March 31, 2006. Gross margin was 27% for the three months ended March 31, 2007, compared to 20% for the three months ended March 31, 2006. The improvement in gross margin for the quarter was primarily due to increased contributions from higher margin gaming technology subsidiaries. Out of their 19% revenue mix, gross profit of the Company's gaming technology businesses represented 39% of the quarter's total gross profit. Gross margins of the Company's gaming technology businesses averaged more than 50%.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses totaled $1,567,000 for the three months ended March 31, 2007, an increase of 45% as compared to $1,079,000 for the first quarter of FY2006. Selling, general and administrative expenses as a percentage of revenue, however, recorded only a small quarter-over-quarter increase from 16% to 17%. Selling, general and administrative expenses consist primarily of staff salaries, rent, insurance and traveling costs. The quarter-over-quarter increase in total general and administrative expenses during the three months ended March 31, 2007 was mainly due to the increase in consultant and labor costs as a result of new product development as well as rental and utilities expenses for the expansion of the Company's gaming technology subsidiaries and call centers in Hong Kong and China.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	Three months ended March 31,		
(in thousands, except percentages)	2007 ($)	2006 ($)	Percentage Change (%)
Remuneration and related	1,041	581	79
Office	300	215	40
Travel	91	40	128
Entertainment	40	16	150
Professional (legal and consultant)	290	65	346
Audit	20	18	11
Selling	111	52	113
Other	52	92	(43)
Recovery of provisions for doubtful accounts	(378)	-	n/a
Total	1,567	1,079	45

INCOME / (LOSS) FROM OPERATIONS

On a quarter-over-quarter basis, income from operations for the three months ended March 31, 2007increased to $800,000, a significant increase of 1,100% as compared to $62,000 for the same period of prior year. Segmented operating incomes of $400,000, $3,000, and $1,196,000 for the three months ended March 31, 2007 were generated from the Company's three business groups: (1) CRM Outsourcing Services, (2) Telecom Value-Added Services, and (3) Products (Telecom & Gaming) Services, respectively. This compares to operating incomes of $206,000, $15,000 and $359,000 from the same groups for the same period last year, respectively. Improved profitability of continuing operations evidenced the success of the Company's new gaming technology strategy, as reflected by the significant gaming technology operating income.

INCOME TAXES

Income tax provision was $68,000 for the three months ended March 31, 2007, a quarter-over-quarter increase of 300% as compared to $17,000 for the same quarter last 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 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 months ended March 31, 2007 totaled $534,000 compared with $86,000 for the same period of the prior year, representing minority ownership interests in subsidiaries consolidated in the Company's consolidated financial statements.

NET INCOME

Net income for the three months ended March 31, 2007 amounted to $308,000, recording a quarter-over-quarter decrease of 62% as compared to $801,000 for the same quarter of prior year. This was solely due to diminishing income from discontinued operations as a result of the Company shifting from VAS businesses that are highly susceptible to adverse billing policy changes administered by China Mobile.

CASH

Net cash and cash equivalents at March 31, 2007 were approximately $4.04 million, an increase of approximately $2.14 million compared to December 31, 2006. This was primarily due to successful collection of certain doubtful debts of approximately $300,000 and 50% net proceeds ($2.3 million) from issuance of convertible debenture for the Company's gaming technology business, net of acquisition of property and equipment of approximately $900,000.

CONTRACTUAL OBLIGATIONS

Contractual obligations as of March 31, 2007 are detailed below (in thousands of US Dollars):

Payments Due by Period

Contractual Obligations	Total	Less than 1 year	1-5 years	After 5 years
Line of credit	$ 404	$ 404		
Bank Loans	$ 3,213	$ 933	$ 870	$ 1,410
Operating leases	$ 1,339	$ 655	$ 684	$
Capital leases	$ 214	$ 110	$ 104	$
Total cash contractual obligations	$ 5,170	$ 2,102	$ 1,658	$ 1,410

In addition to above, as previously disclosed in the paragraph under the sub-heading of PROBABLE EVENT OF DEFAULT under Item 7 - 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 March 31, 2007, the Company has accrued three months of liquidated damages and mandatory 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

There were no off-balance sheet guarantees, interest rate swap transactions, foreign currency forward contracts or long term purchase commitments outstanding as of March 31, 2007. Further, the Company had not engaged in any non-exchange trading activities during first quarter of 2007.

PART II - OTHER INFORMATION

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

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.	PACIFICNET INC.	
Date: December 11, 2007	By:	/s/ TONY TONG Tony Tong Chief Executive Officer (Principal Executive Officer)
Date: December 11, 2007	By:	/s/ DANIEL LUI Daniel Lui Chief Financial Officer (Principal Financial Officer)