PACIFICNET INC
Form 10-Q/A
December 17, 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 JUNE 30, 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 August 1, 2007, there were11,984,072 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-A") is being filed as Amendment No. 1 to our Quarterly Report on Form 10-Q for the period ended June 30, 2007, which was originally filed with the Securities and Exchange Commission ("SEC") on August 21, 2007. We are amending and restating the following specific items in this Amendment No. 1:

1. Part I. Item 1. Financial Statements - to restate the financial statements as of, and for the three and six months ended June 30, 2007, and to restate the balance sheet as of December 31, 2006;

2. Part I. Item II. Management's Discussion And Analysis of Financial Condition and Results of Operations.

3. Part II. Item 6 - to update the officer certifications for this amended filing.

PACIFICNET INC.
Form 10-Q/A for the Quarterly Period Ended June 30, 2007

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	June 30, 2007 Unaudited Restated	December 31, 2006 Audited Restated
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,725	$ 1,900
Restricted cash - pledged bank deposit	237	234
Accounts receivables, net	9,649	8,141
Inventories	391	201
Loan receivable from related parties	2,351	1,706
Loan receivable from third parties	827	128
Marketable equity securities - available for sale	575	558
Loans to employees	3,293	770
Other receivables, net	490	170
Other current assets	2,251	3,233
Total Current Assets	24,789	17,041
Property and equipment, net	6,925	4,711
Investments in affiliated companies and subsidiaries	34	1,257
Intangible assets, net	337	323
Goodwill	6,258	5,601
Other assets	45	471
Net assets held for disposition	2,535	7,522
TOTAL ASSETS	$ 40,923	$ 36,926
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Bank line of Credit	$ 299	$ 855
Bank loans-current portion	642	576
Capital lease obligations - current portion	100	120
Accounts payable	1,764	1,266
Accrued expenses and other payables	1,921	1,828
Customer deposits	352	352
Loans payable to related party	577	638
Convertible debenture	6,763	8,945
Warrant liability	824	904
Liquidated damages liability	2,697	2,837
Total Current Liabilities	15,939	18,321
Long-term liabilities:		
Bank loans - non current portion	2,162	1,635
Capital lease obligations - non current portion	83	124
Convertible Debenture- non current portion	4,740	-
Total long-term liabilities	6,985	1,759

Total liabilities		22,924		20,080
Minority interest in consolidated subsidiaries		3,272		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: June 30, 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 Q2: 2,572,969 shares, 2006: 2,616,933 shares)		(145)		(272)
Additional paid-in capital		67,003		65,757
Cumulative other comprehensive income (loss)		(139)		(42)
Accumulated deficit		(51,509)		(51,090)
Less: stock subscription receivable		(484)		(377)
Total Stockholders' Equity		14,727		13,977
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	40,923	$	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 month periods ended June 30		Six month periods ended June 30	
	2007 Unaudited Restated	**2006 Unaudited Restated**	**2007 Unaudited Restated**	**2006 Unaudited Restated**
Net Revenues				
Services	$ 4,299	$ 4,300	$ 8,864	$ 8,035
Product sales	4,722	8,914	9,424	11,851
Total Net Revenues	9,021	13,214	18,288	19,886
Cost of revenues				
Services	(2,832)	(2,909)	(6,185)	(5,486)
Product sales	(3,828)	(8,528)	(7,203)	(11,271)
Total Cost of Revenues	(6,660)	(11,437)	(13,388)	(16,757)
Gross Profit	2,361	1,777	4,900	3,129
Selling, general and administrative expenses	(1,798)	(1,416)	(3,365)	(2,496)
Stock-based compensation expenses	-	(60)	-	(242)
Depreciation and amortization	(216)	(129)	(388)	(158)
Total Operating Expenses	(2,014)	(1,605)	(3,753)	(2,896)
INCOME FROM OPERATIONS	347	172	1,147	233
Other Income (Expenses):				
Interest income (Expenses), net	(232)	(341)	(432)	(393)
Gain in change in fair value of derivatives	20	208	81	208
Sundry income, net	27	48	46	63
Total Other Income (Expenses)	(185)	(85)	(305)	(122)
Income before Income Taxes, Minority Interest and Discontinued Operations	162	86	842	111
Provision for income taxes	22	(13)	(46)	(30)
Share of earnings of associated companies	-	52	-	49
Minority interests	(340)	(179)	(874)	(265)
Loss from Continued Operations	(156)	(54)	(78)	(135)
Loss on disposal	-	-	(971)	-

Income from discontinued operations		400		850		630		1,732
Total discontinued operations income (loss)		400		850		(341)		1,732
Net Income (Loss)		244		796		(419)		1,597
Other comprehensive income/(loss)								
Foreign exchange gain (loss)		(126)		-		(97)		(20)
Net Comprehensive Income (Loss)	$	118	$	796	$	(516)	$	1,577
Basic Earnings (Loss) per share-Continued Operations	$	(0.01)	$	(0.00)	$	(0.01)	$	(0.01)
Basic Earnings (Loss) per share-Discontinued Operations	$	0.03	$	0.08	$	(0.03)	$	0.16
Basic Earnings (Loss) per share	$	0.02	$	0.07	$	(0.04)	$	0.15
Diluted Earnings (Loss) per share-Continued Operations	$	(0.01)	$	(0.00)	$	(0.01)	$	(0.01)
Diluted Earnings (Loss) per share-Discontinued Operations	$	0.03	$	0.08	$	(0.03)	$	0.16
Diluted Earnings (Loss) per share	$	0.02	$	0.07	$	(0.04)	$	0.15
Weighted average number of shares-Basic		11,703,376		11,001,522		11,742,942		10,918,372
Weighted average number of shares-Diluted		11,979,949		11,001,522		12,019,514		10,918,372

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

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

	FOR THE SIX MONTH PERIODS ENDED JUNE 30			
		2007 Unaudited Restated		2006 Unaudited Restated
Cash Flows from operating activities				
Net income	$	(419)	$	1,597
Adjustments to reconcile net income/(loss) to net cash provided by (used in) operating activities:				
Equity loss of associated companies		-		(49)
Provision for allowance for doubtful accounts		(691)		-
Minority Interest		874		265
Depreciation and amortization		646		158
Unrealized gain on marketable equity securities		-		(2)
Change in fair value of derivatives		(81)		-
Changes in current assets and liabilities net of effects from purchase of subsidiaries:				
Accounts receivable and other current assets		(2,043)		(11,637)
Inventories		(190)		42
Accounts payable and other accrued expenses		1,650		1,582
Net cash used in operating activities of continued operations		(254)		(8,044)
Net cash provided by operating activities of discontinued operations		2,466		1,732
Net cash provided by operating activities		2,210		(6,312)
Cash flows from investing activities:				
Decrease in restricted cash		(3)		163
Increase in purchase of marketable securities		(17)		(24)
Acquisition of property and equipment		(1,928)		(3,124)
Acquisition of subsidiaries and affiliated companies		88		(4)
Net cash used in investing activities of continued operations		(1,860)		(2,989)
Net cash provided by investing activities of discontinued operations		-		-
Net cash used in investing activities		(1,860)		(2,989)
Cash flows from financing activities:				
Decrease in loan receivables		-		3,339
Loan payable to related party		(61)		(2,160)
Loans receivable from third parties		(699)		-
Loans receivable from related party		(1,671)		(189)
Stock subscription recevables		-		(13)
Repayments under bank line of credit		(556)		(170)
Repayments of amount borrowed under capital lease obligations		(61)		(73)
(Purchase) sale of treasury shares		127		(124)
Proceeds from exercise of stock options and warrants		-		86
Net proceeds from issuance of convertible debenture		5,685		8,000

Advances under bank loans		(192)		1,706
Net cash provided by financing activities of continued operations		2,572		10,402
Net cash provided by financing activities of discontinued operations		-		-
Net cash provided by financing activities		2,572		10,402
Effect of exchange rate change on cash and cash equivalents		(97)		-
NET INCREASE IN CASH AND CASH EQUIVALENTS		2,825		1,101
CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD		1,900		3,486
CASH AND CASH EQUIVALENTS, END OF THE PERIOD	$	4,725	$	4,587
CASH PAID FOR:				
Interest	$	221	$	87
Income taxes	$	-	$	32
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Proceed from Option exercised for share 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 $51.5 million and $51.1 million as of June 30, 2007 and December 31, 2006, respectively. These matters raise substantial doubt about the Company's ability to continue as a going concern.

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

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

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

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

2. RECENT PRONOUNCEMENTS

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

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

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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 June 30, 2007 exclude the potential dilutive effect of 889,456 warrants because their impact would be anti-dilutive based on current market prices. 581,817 convertible debentures are tested by using if-converted method. The result shows when convertible debentures are included in the computation, diluted EPS increases. According to SFAS No.128, those convertible debentures are ignored in the computation of diluted EPS. All per share and per share information are adjusted retroactively to reflect stock splits and changes in par value.

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

(IN THOUSANDS OF UNITED STATES DOLLARS, EXCEPT WEIGHTED SHARES AND PER SHARE AMOUNTS)	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Numerator: Earnings/ (Loss)	$ 244	$ 796	$ (419)	$ 1,597
Denominator:				
Weighted-average shares used to compute basic EPS	11,703,376	11,001,522	11,742,942	10,918,372
Weighted-average shares used to compute diluted EPS	11,979,949	11,001,522	12,019,514	10,918,372
Basic earnings (loss) per common share:	$ 0.02	$ 0.07	$ (0.04)	$ 0.15
Diluted earnings (loss) per common share:	$ 0.02	$ 0.07	$ (0.04)	$ 0.15

4. OTHER CURRENT ASSETS

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

	June 30, 2007 Unaudited Restated	December 31, 2006 Audited Restated
Prepayment	$ 600	$ 1,048
Utilities deposit	1,042	1,292
Receivable from Lion Zone Holdings Ltd	385	485
Prepaid expenses	224	408
Total	$ 2,251	$ 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
Goodwill acquired during the second quarter	-	-	-	-
Balance as of June 30, 2007	$ 3,964	$ 461	$ 1,833	$ 6,258

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

6. ACCRUED EXPENSES & OTHER PAYABLES

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

(in thousands of US Dollars):	2007 Unaudited Restated	2006 Audited Restated
Professional fee	$ 692	$ 321
Director fee	174	100
Salaries and benefit payable	243	792
Marketing expense	627	389
Others	185	226
Total	$ 1,921	$ 1,828

7. STOCKHOLDERS' EQUITY

a) COMMON STOCK

For the six month period ended June 30, 2007, the Company had the following equity transactions: (i) 199,444 shares of common stock were issued as the monthly principal redemption shares for 8 million convertible debentures from January to March. Such shares are valued at $ 1,090,914 (ii) 41,426 treasury shares were sold to the open market with total consideration $127,000.

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 June 30, 2007, no new options were granted and no options were vested, thus the compensation costs is zero. PacificNet elected the modified prospective method and therefore has not restated results for prior periods due to 123R.

The status of the Stock Option Plan as of June 30, 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
Granted	**-**		-
Cancelled	**-**		-
Exercised	**-**		-
OUTSTANDING JUNE 30, 2007	**370,500**	$	2.00

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

Grant Date	Total Options Outstanding	Aggregate Intrinsic Value	Weighted Average Remaining Life (Years)	Total Weighted Average Exercise Price	Option Exercisable	Weighted Average Exercise Price
2004-7-26	370,500	$ 1,063,335	0.07	$ 2.00	370,500	$ 2.00

The 370,500 outstanding options, which were granted during 2004, will be expired on July 26, 2007. Those options were vested from July 1, 2005 with a 10 month vesting period, and the corresponding compensation costs 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, exercised and vested during the six month period ended June 30, 2007.

c) WARRANTS

At June 30, 2007, the Company had outstanding and exercisable warrants to purchase an aggregate of 1,007,138 shares of common stock. The weighted average remaining life is 2.84 years and the weighted average exercise price per share is $10.61 per share.

Following is a summary of the warrant activity:

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

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

Grant Date	Total warrants Outstanding	Weighted Average Remaining Life (Years)		Total Weighted Average Exercise Price	Warrants Exercisable		Weighted Average Exercise Price
2004-1-15	123,456	1.54	$	7.15	123,456	$	7.15
2004-11-15	117,682	2.38	$	3.89	117,682	$	3.89
2004-12-9	350,000	2.44	$	12.21	350,000	$	12.21
2006-3-13	416,000	3.7	$	12.20	416,000	$	12.20

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

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

No warrants were granted, cancelled and exercised during the six month period ended June 30, 2007.

d) TREASURY STOCK

The following is a summary of the movement of the Company's shares held as treasury stock as at June 30, 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, June 30, 2007	2,572,969
Shares outstanding at June 30, 2007	11,782,072
Shares issued at June 30, 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 24, 2007 to January 30, 2007, we sold 41,426 treasury shares to the open market for total consideration of $127,000.

8. CONVERTIBLE DEBENTURES

8.1 Eight Million Convertible Debentures

On March 13, 2006, we completed a private placement in which we sold $8,000,000 in convertible debentures and issued warrants to purchase up to an aggregate of 400,000 shares of common stock. The debentures are convertible at any time into shares of our common stock at an initial fixed conversion price of $10.00 per share, subject to adjustments for certain dilutive events. The debentures are due March 13, 2009. The warrants are exercisable for a period of five years at an exercise price of $12.20 per share. At the closing of the private placement, we prepaid the first year's interest on debentures equal to 5% of the aggregate principal amount of debentures. We will pay interest in cash or shares, provided that certain conditions are met, at the rate of 6% for the second year the debentures are outstanding and then 7% for the third. Beginning January 1, 2007, we are obligated to redeem up to $320,000 every month, plus accrued, but unpaid interest, liquidated damages and penalties. We also have the option to prepay the debentures at any time, provided that certain conditions have been met, after the 12 month anniversary of the effective date of the registration statement that has been filed with the Securities and Exchange Commission with respect to the common stock issuable upon conversion of the debentures, some or all of the outstanding debentures for cash in an amount equal to 120% of the principal amount outstanding, plus accrued, but unpaid interest, liquidated damages and penalties outstanding. At any time after the 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 June 30, 2007 is $5,977,273.

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 $20,071 and $80,765 representing the change in fair value of warrants recognized during the three and six months ended June 30, 2007, respectively.

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

EVENT OF DEFAULT

On March 16, 2007 our predecessor auditor withdrew their opinion on our previously filed financial statements for the years ended December 31, 2005, December 31, 2004 and December 31, 2003. As a result, on March 27, 2007, we notified the holders of the outstanding convertible debenture that we suspended use of the prospectus contained in our Registration Statement on Form S-1 (File No. 333-134127) that was declared effective on December 8, 2006, due to the lack of fiscal year end 2005 and 2004 audited financial statements and that they must cease selling under the prospectus. The suspension of the use of the prospectus after April 17, 2007, triggered an event of default under the registration rights agreement and the convertible debentures, and if any of the holders so elect, they 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)	June 30, 2007		
Liquidated damages	2%	$	450
Mandatory default	30%		2,247
Total		$	2,697

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

Following is the summary of convertible debenture:

($,000)		$8 million convertible debenture		$945,000 convertible debenture		Total (unaudited)
Balance December 31, 2006	$	8,000	$	945	$	8,945
Principal payment:						
Redemption through shares		1,091		-		1,091
Cash payment		1,091		-		1,091
Balance June 30, 2007	$	5,818	$	945	$	6,763

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

8.2 Five Million Convertible Note

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

The $5 million convertible secured note issued to Pope matures on February 6, 2010. Subject to reaching certain net income milestones during fiscal year 2007, the note is convertible into an equity interest of PacGames ranging between 26% and 32%. The interest rate of the convertible note has initially been set at 8%, and shall increase to 15% if the note is not converted prior to maturity. PacGames received the payment of $2.5 million and $2.5 million respectively for the first and second 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.

Following is the summary of convertible debenture:

($,000)	June 30, 2007
Convertible debenture	$ 5,000
Unamortized financing cost	(260)
	$ 4,740

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 Wanrong, ChinaGoHi (discontinued), Linkhead (discontinued), Clickcom (discontinued) and Guangzhou 3G/Sunroom (discontinued). For example, Linkhead is a master reseller of NMS hardware and software platforms in China, and its voice cards are used as an integral part of voice hardware using CPCI industry control machines, and also by Media Servers to support access from PSTN and VoIP, Softswitch and 3G networks.

(3) Product (Telecom & Gaming) Services Group - involves communication and gaming products, GSM/CDMA/3G Products, Multimedia Communication Kiosks. This Group includes the following subsidiaries: PacificNet Communications Limited, iMobile, Allink, 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 June 30, 2007	Group 1.	Group 2.	Group 3.	Group 4.	
(in thousands, except percentages)	Outsourcing Services ($)	Telecom Value-Added Services ($)	Products (Telecom & Gaming) ($)	Other Business ($)	Total (Restated) ($)
Revenues	3,767	432	4,722	100	9,021
(% of Total Revenues)	42%	5%	52%	1%	100%

Income / (Loss) from Operations	241	353	378	(625)	347
(% of Total Profit)	69%	102%	109%	(180)%	100%
Total Assets	7,985	4,140	18,203	10,595	40,923
(% of Total Assets)	20%	10%	44%	26%	100%
Goodwill	3,964	461	1,833		6,258
Geographic Area	HK, PRC				