PACIFICNET INC
Form 10KSB/A
October 25, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-KSB/A
(Amendment No. 3)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005

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

Registrant's Telephone Number: 0086-10-59225000

601 New Bright Building, 11 Sheung Yuet Road, Kowloon Bay, Kowloon, Hong Kong.
(Former Name and Address)

Securities Registered under Section 12(b) of the Exchange Act: NONE

Securities Registered under Section 12(g) of the Exchange Act: Common Stock, par value $0.0001

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act [ ]

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES [X]   NO [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12(b) of the Exchange Act).
Yes [ ]   No [X]

Issuer's revenue for its most recent fiscal year: $44,341,000. The aggregate market value of the common stock held by non-affiliates of the registrant as of March 31, 2006 was approximately $66,627,235 based upon the closing sale price of $7.39 per share as reported by The NASDAQ National Market on such date. There were 13,238,497 shares of the Company's common stock outstanding on March 31, 2006.

Transitional Small Business Disclosure Format (check one):   Yes [ ]   No [X]

DOCUMENTS INCORPORATED BY REFERENCE - NONE

Explanatory Note:

This Annual Report on Form 10-KSB/A ("Form 10-KSB/A") is being filed as Amendment No. 3 to our Annual Report on Form 10-KSB for the year ended December 31, 2005, which was originally filed with the Securities and Exchange Commission (the "SEC") on April 28, 2006. We are amending and restating the following items in this amendment:

(i) Part II. Item 6. Management's Discussion and Analysis
(ii) Part II. Item 7. Financial Statements
(iii) Part III. Item 9. Directors, Executive Officers, Promoters and Control Persons: Compliance with Section 16(a) of the Exchange Act to update officer information for our new Chief Financial Officer who will be signing the certifications in Exhibits 31 and 32.
(iv) Part III. Item 13. Exhibits and Reports on Form 8-K to reflect the inclusion of updated officer certifications in Exhibits 31 and 32 for this amended filing.
(v) Part III. Item 14. Principal Accountant Fees and Services, to reflect the fees of our new auditor in connection with the re-audits of the fiscal years ended December 31, 2005 and 2004.

TABLE OF CONTENTS

PART II
ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION
ITEM 7. FINANCIAL STATEMENTS-RESTATED
ITEM 8A. CONTROLS AND PROCEDURES

PART III
ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT
ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K
ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

This annual report contains forward-looking statements within the meaning of the federal securities laws. These include statements about our expectations, beliefs, intentions or strategies for the future, which we indicate by words or phrases such as "anticipate," "expect," "intend," "plan," "will," "we believe," "the Company believes," "management believes" and similar language. The forward-looking statements are based on our current expectations and are subject to certain risks, uncertainties and assumptions, including those set forth in the discussion under "Description of Business," including the "Risk Factors" described in that section, and "Management's Discussion and Analysis or Plan of Operation." Our actual results may differ materially from results anticipated in these forward-looking statements. We base our forward-looking statements on information currently available to us, and we assume no obligation to update them.

PART II

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

FORWARD-LOOKING STATEMENTS This annual report on Form 10-KSB, as amended, contains forward-looking statements within the meaning of the federal securities laws. These include statements about our expectations, beliefs, intentions or strategies for the future, which we indicate by words or phrases such as "anticipate," "expect," "intend," "plan," "will," "we believe," "management believes" and similar language. The forward-looking statements are based on our current expectations and are subject to certain risks, uncertainties and assumptions, including those set forth in the discussion under "Description of Business," including the "Risk Factors" described in that section, and "Management's Discussion and Analysis or Plan of Operation." Our actual results may differ materially from results anticipated in these 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
- 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 13 years of field experience in 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 o less familiarity on partners' product knowledge
- deployment costs of a new HR application and the costs to upgrade the call center computer system o 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

Our discussion and analysis 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 certain estimates and judgments that affect the reported amount of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to research and development, long-lived assets including goodwill and purchased intangible assets, allowance for doubtful accounts, inventories, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that we believe 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 the most significant estimates and assumptions used in the preparation of its consolidated financial statements.

RESEARCH AND DEVELOPMENT

We evaluate research and development costs to identify any research and development activities that could be objectively measured and recognized as an asset for accounting purposes at the time they are acquired or at the time they have developed future economic benefits. Some costs and expenses are recognized as costs and expenses incurred during the period, provided that (a) there are no discernible future benefits, (b) costs recorded as assets in prior periods no longer provide discernible benefits, and (c) allocating costs either on the basis of association with revenue or among several accounting periods is considered to serve no useful purpose.

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 the 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 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 income, thereby reducing our net profit.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

We evaluate the collected ability 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 doubtful accounts to reduce the related receivable to the amount we reasonably believe is collectible. We also record reserves for doubtful accounts 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 income, thereby reducing our net profit. 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.

TAXES ON EARNING

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, 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. 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.

RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board issued the following accounting pronouncements:

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections". SFAS No. 154 replaces APB Opinion No. 20 "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The adoption of SFAS No. 154 did have an impact on the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123R (revised 2004) "Share-Based Payment" which amends FASB Statement No. 123 and will be effective for public companies (small business issuers) for interim or annual periods beginning after December 15, 2005. SFAS 123R requires that compensation cost related to share-based payment transactions be recognized in the financial statements. Share-based payment transactions within the scope of SFAS 123R include stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee share purchase plans. The Company adopted the new standard as of January 1, 2006. Based on the Company's evaluation of the adoption of the new standard, the Company believes that it could have a significant impact to the Company's financial position and overall results of operations depending on the number of stock options granted in a given year.

In February 2007, FASB issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. FAS159 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.

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.

6

RESULTS OF OPERATIONS (RESTATED)

The following table sets forth selected statement of operations data as a percentage of revenue for the periods indicated.

	YEAR ENDED DECEMBER 31,	
	2005 (%) Restated	2004 (%) Restated
Revenues	100	100
Cost of Revenues	(66.5)	(72.5)
Gross Margin	33.5	27.5
Selling, general and administrative expense	(33.5)	(31.1)
Depreciation and amortization	(1.1)	(0.6)
Loss from operations	(13.9)	(27.1)
Interest (expenses) income, net	(0.3)	(0.4)
Sundry income	2.1	3.1
Provision for income taxes	(0.9)	(0.6)
Share of profit of associated companies	2.8	0.5
Minority interest	(6.9)	(7.5)
Discontinued operations	0.0	0.0
NET LOSS	(16.6)	(32.0)

RESTATEMENT

On March 19, 2007 the Company's predecessor auditor, Clancy and Co. P.L.L.C., withdrew its 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. Despite independent investigation in this connection commissioned by our Audit Committee resulting in extra stock-based compensation charges of approximately $0.3 million, $1.2 million and $0.1 million to each of the years ended December 31, 2005, 2004 and 2003, respectively, the predecessor auditor did not re-instate its opinion.

The Company engaged the incumbent auditors to conduct a reaudit of the financial statements for the years ended December 31, 2005 and 2004. In the course of the reaudit, management determined that the Company had never had control over Yueshen, a 51% owned subsidiary in the context of FAS 94. As a result of excluding Yueshen from the Company's consolidated statement operations, net revenues of the Company for each of the years ended December 31, 2005 and 2004 were reduced by $13.3 million and $12.5 million, respectively. Accordingly, gross profit of the Company for each of the years ended December 31, 2005 and 2004 were reduced by $0.5 million and $1 million, respectively.

Due to time lapse and the lack of cooperation on the part of current management of certain former subsidiaries that the Company disposed of during 2006, extra provisions for doubtful accounts of approximately $3.5 million and $281,000 were charged to the restated operating expenses for the years ended December 31, 2005 and 2004 to compensate for the lack of audit evidence for certain deposits, prepayments and receivables alike.

Further, extra goodwill impairment amounting to approximately $3.7 million and $2.6 million, respectively, have been moved forward from fiscal year 2006 for charging to the restated Selling, General and Administrative expenses for the

years ended December 31, 2005 and 2004 with the benefit of the hindsight of knowing the corporate restructure that took place in fiscal year 2006. In the course of the reaudit, the Company has also increased the restated Selling, General and Administrative expenses for the year ended December 31, 2005 to account for approximately $600,000 of previously unaccrued 2005 bonus paid by a former subsidiary (ChinaGoHi) in 2006.

In summary, the above, combined with others, has a net effect of reducing the net profits (FY2005: $2.6M; FY2004: $774,000) as reported in previous form 10-KSB into deficits (FY2005: -$5.1M; FY2004: -$5.4M) as restated in this Form 10-KSB.

Further details of the effects of the restatement are found below in Note 16 - Restatement to the audited financial statements contained in this form 10-KSB.

REVENUES

Revenues for the year ended December 31, 2005 were amounted to $31,086,000, which represented a year-over-year increase of 83% as compared to $16,942,000 for the year ended December 31, 2004. The increase in revenues was mainly due to revenues derived from the value-added telecom services rendered by the Company's newly acquired subsidiaries, Guangzhou3G ($5,141,000), Clickcom ($660,000) and Lion Zone ($1,190,000). In the aggregate, the three newly acquired subsidiaries contributed to22 % of the total revenues. Revenues from the VAS and IVR segment can vary from quarter to quarter due to new product launches and the seasonality of certain product lines. Segmented financial information of the four business operating groups is set out below followed by a brief discussion of each business group.

YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004.

For the year ended December 31, 2005 (in thousands of US Dollars, except percentages	Group 1. Outsourcing Business ($) Restated	Group 2. Value-Added Telecom Business ($) Restated	Group 3. Communication Products Distribution Business ($) Restated	Group 4. Other Business ($) Restated	Total ($) Restated
Revenues	13,568	13,779	2,880	859	31,086
(% of Total Revenues)	44%	44%	9%	3%	100%
Earnings / (Loss) from Operations	686	1,274	(106)	(6,187)	(4,333)

For the year ended December 31, 2004 (in thousands of US Dollars, except percentages	Group 1. Outsourcing Business ($) Restated	Group 2. Value-Added Telecom Business ($) Restated	Group 3. Communication Products Distribution Business ($) Restated	Group 4. Other Business ($) Restated	Total ($) Restated
Revenues	9,821	6,084	849	188	16,942
(% of Total Revenues)	58%	36%	5%	1%	100%
Earnings / (Loss) from Operations	862	1,655	(286)	(6,819)	(4,588)

(1) OUTSOURCING SERVICES

Revenues for the year ended December 31, 2005 were $13,568,000, a year-over-year increase of 39% as compared to $9,821,000 for the year ended December 31, 2004. Outsourcing services revenues accounted for 44% of the Company's total revenues for FY 2005 due to its subsidiary being selected by China's State Administration of Taxation to provide integrated call center services training for the tax bureau's "123661" customer services center in

Shenzhen and it is believed that the contact center expansion in Guangzhou will lead to over 40% annual revenue growth in the coming years.

One of the reasons the revenues increased is the continuous rapid growth on computer software product from which the revenues amounted to $3,678,000, representing 27% of total outsourcing revenues in FY2005, a year-over-year increase of 337% as compared to $841,000 for the same periods of prior year.

Besides, providing a seamless solution and multi-media channels for clients to communicate with their customers for building better customer relationship generated more sales revenues. The combination of its innovative infomercials along with our growing call center operations generated about $8,118,000 revenues in FY2005, accounted for 60% of total outsourcing revenues, It is a strong vote of confidence in our future development in China's growing CRM call center market due to our expansion from B2B outsourced call center services into B2C infomercial services market for vertical industries which a growing number of domestic and multinational companies across a number of industries are selecting us to enhance customer services. This demand for CRM services reflects the increasingly competitive nature of the Chinese marketplace where customers choose a provider not solely based upon price, but also on customer services. We believe that our CRM contact center has emerged as the new competitive advantage for the market leaders in China and we are well positioned to benefit from this trend.

(2) VALUE-ADDED TELECOM SERVICES (VAS)

Revenues for the year ended December 31, 2005 was $13,779,000 a significant year-over-year increase of 126% as compared to $6,084,000 for the year ended December 31, 2004. Revenues from 3G, Clikcom and Lion Zone in 2005 contributed to the increase in revenues for this business segment, which amounted to $5,141,000, $660,000 and $1,190,000 respectively, accounted for 37%, 5% and 9% of total VAS revenues, and helped us enter the mobile Internet market in China.

VAS revenues accounted for 44% of the Company's total revenues for FY 2005. Presently, approximately 80% of mobile phone users use VAS in China.

Based on CPCT industry control machines and Media Server which supports access from both PSTN and VoIP, soft switch and 3G networks, the Company's revenue in the sales of voice cards continued to grow and amounted to $6,453,000 in FY 2005, a year-over-year increase of 23% compared to $5,230,000 in FY 2004. These phone cards sold through the VAS segment differ from the calling cards sales in the Communication Distribution Business as described below in that those phone cards are geared towards the end user and include prepaid calling cards, IDD long distance calling cards, internet access cards, bundled cross-selling insurance cards, shopping discount cards, travel and hotel reservation cards, entertainment cards, and customer loyalty membership cards. For example, the Bank of China Shanghai selected PacificNet Epro to provide CRM and call center management training, to enhance agent productivity, to improve call center service quality, and to revise the strategic market positioning for the bank.

On the other hand, revenues from providing telecom information services to customers under partner with China Mobile, China Telecom and other communication service providers for the year ended December 31, 2005 increased to $5,741,000, accounted for 42% of the total VAS revenues and 18% of the total Revenues in FY 2005.

(3) COMMUNICATION PRODUCTS DISTRIBUTION

Revenues from Communication Products Distribution for the year ended December 31, 2005 were $2,880,000, a year-over-year increase of 242% as compared to $841,000 for the year ended December 31, 2004. Communication products distribution revenues made up 9% of the Company's total revenues for the year ended December 31, 2005. The increased Distribution revenue was mainly due to the expanding of market promotion activities to meet the increasing market growth in communication products distribution services.

(4) OTHER BUSINESS

Revenues for the year ended December 31, 2005 were $860,000, a significant year-over-year increase of 357% as compared to $188,000 for the year ended December 31, 2004. This increased revenue was mainly due to the web maintenance service by PacificNet Limited which generated revenues of $523,000 in FY 2005, an increase of 179% as

compared to $188,000 in FY2004. Moreover the incorporation of PacificNet Power on Jan 2005 increased the revenues ($336,000) in FY 2005.

COST OF REVENUES AND GROSS MARGIN

Cost of revenues for the year ended December 31, 2005 was $20,678,000, an increase of 68% from $12,286,000 for the year ended December 31, 2004. The slight increase in the cost of revenues was directly associated with the increase in revenue. Cost of revenue, as a percentage of revenue, was 67% for the year ended December 31, 2005 as compared with 73% for the year ended December 31, 2004. The decrease in cost as a percentage of revenues was attributable to the changes in operations, from supplying systems integration and software applications in 2004 to becoming value-added telecom services and product providers in 2005.

Gross profit for the year ended December 31, 2005 was $10,408,000 an increase of 124% as compared to $4,656,000 for the year ended December 31, 2004, resulting from gross margin contributions from our newly acquired subsidiaries in 2005: Guangzhou3G ($3,000,000), Clickcom ($597,000) and Lion Zone ($1,190,000), which accounted for 29%, 6% and 11% of total Gross Profit.

Our gross margin overall was 33% in the year ended December 31, 2005 (2004:27%) and approximated the industry standards. The slight increase in gross margin came primarily from providing telecom information services which had generated Gross profit of $8,499,000 and Gross margins of 40%.

(1) OUTSOURCING SERVICES

As compared to prior year, cost of revenues for outsourcing services increased to $10,366,000, 48% higher at $6,984,000 in FY 2004. Gross profit was 13% higher at $3,202,000 (2004: $2,837,000).The increase in Gross profit was mainly due to the increasing demand for outsourcing contact center services, especially from the industries of telecom, banking, market research and fast-moving consumer goods, among others. From the perspective of high-margin IT Solutions, EPRO enjoyed growth in FY2005 from its self-developed Contact Center System - WISE-xb Contact Center System and TNT Hong Kong selected this contact center solution with customer management capabilities to improve efficiency and enhance customer satisfaction.

(2) VALUE-ADDED TELECOM SERVICES (VAS)

As compared to prior year, cost of revenues for VAS increased to $7,457,000 in FY 2005, an increase of 70% as compared to $4,399,000 in FY 2004. The increased cost of VAS revenues was mainly derived from our newly acquired subsidiaries in the year of 2005, Guangzhou3G, Clickcom and Lion Zone, the cost of revenues form which amounted to $2,141,000, $63,000 and $0 respectively. In the aggregate, the cost of VAS revenues from the three newly acquired subsidiaries contributed to 30 % of the total cost of VAS revenues in FY 2005.

The Gross profit amounted to $6,322,000 for the year ended December 31, 2005, a significant increase of 275% as compared to $1,686,000 for the same periods of 2004. The increased gross profit was mainly due to the new acquisitions in the year of 2005, Guangzhou3G, Clickcom and Lion Zone, from which the Gross profit amounted to $3,000,000, $597 and $1,190,000 respectively. The acquisitions for the newly companies helped our company moved our strategic consolidation in China's CRM and VAS market, and increased our customer base and improved our gross margin. the continued profitability in the sale of phone cards. Furthermore, our company increased market share in the voice/IVR supplier market.

(3) COMMUNICATION PRODUCTS DISTRIBUTION

Cost of revenues from communication products distribution for the year ended year ended December 31, 2005 amounted to $2,572,000, a significant year-over-year increase of 206% as compared to $841,000 for the same periods of 2004. The increased cost of revenue was associated with the increased revenues from communication products distribution as the expanding of promotion market activities. Gross profit was 4,001% higher at $307,000 (2004: $7,000).

(4) OTHER BUSINESS

Cost of revenues and Gross profit for PacificNet Power for the year ended December 31, 2005 was $283,000 and $577,000, a significant increase of 356% and 358% compared to $62,000 and $126,000 respectively for the year ended December 31, 2004. This was mainly due to the incorporation of PacificNet Power on Jan 2005, which generated about $269,000 cost of revenues and $67,000 Gross Profit.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, General and Administrative expenses ("SG&A") totaled $10,420,000 for the year ended December 31, 2005, which represents a year-over-year increase of 98% as compared to $5,267,000 for the year ended December 31, 2004. The significant increase in selling, general and administrative expenses reflected the expansion of our operations of which expenses were incurred by our newly acquired subsidiaries: Guangzhou3G ($922,000), Clickcom ($611,000) and Lion Zone ($3,097,000), and the expansion of the management team. In addition to making several key acquisitions in 2005, we laid the foundation for a strong future, by hiring additional personnel in key areas to support

our accounting and back-office functions, as well as implemented the systems to allow the Company to better measure the performance of each of its units.

(1) OUTSOURCING SERVICES

Selling, General and Administrative expenses for outsourcing services were $2,261,000 for the year ended December 31, 2005, an increase of 19% from $1,907,000 for the year ended December 31, 2004. For the increase in the demand for telemarketing and call center services, PacificNet Epro purchased a new 250-seat call center facility in China to support the rapidly growing business of the company, which caused an increase of 8% from $1,618,000 for the year ended December 31, 2004 to $1,752,000 for the year ended December 31, 2005, accounted for 78% of the total SG&A from outsourcing services. However, a wide array of supporting services are provided, including professional inbound services, outbound services, facilities management and IVRS support services, to meet clients' diversified needs.

(2) VALUE-ADDED TELECOM SERVICES (VAS)

Selling, General and Administrative expenses for VAS increased from $22,000 for the year ended December 31, 2004 to $4,973,000 for the year ended December 31, 2005.The increase of SG&A expense resulted from the increasing size of our operations which included premises cost and staff costs from the three new acquisitions, Guangzhou3G, Clickcom and LionZone, of which SG&A amounted to $922,000, $611,000and $3,097,000 respectively, and accounted for 30%, 20% and 38% of the total SG&A from VAS.

(3) COMMUNICATION PRODUCTS DISTRIBUTION

Selling, General and Administrative expenses for this group were $413,000 for the year ended December 31, 2005, a significant year-over-year increase of 57 % as compared to $263,000 for the year ended December 31, 2004. The increased SG&A was mainly derived from bad debts ($223,000), and Sunday expenses ($11,000) by PacificNet Communications as the expanding of Market share.

(4) OTHER BUSINESS

Selling, General and Administrative expenses were $2,773,000 for the year ended December 31, 2005, a year-over-year decrease of 9.8% as compared to $3,075,000 for the same periods of FY 2004.

DEPRECIATION AND AMORTIZATION EXPENSES

Depreciation and amortization expenses were $351,000 for the year ended December 31, 2005, which represented an increase of 241% as compared to $103,000 for the year ended December 31, 2004.

OPERATING LOSS

Operating Loss of $4,333,000 for the year ended December 31, 2005, a decrease of 6% as compared to $4,588,000 from the year ended December 31, 2004. Operating Loss margins for the year ended December 31, 2005 was14% as compared to 27% in the previous year. Annual operating loss of $(686,000), $(1,274,000) and $106,000 generated from the Company's three business units: (1) CRM Outsourcing Services, (2) Value-Added Services (VAS) and (3) Telecom Distribution Services, as compared to $(862,000), $(1,655,000), and $287,000 for the same periods of prior year.

INTEREST INCOME / (EXPENSES), NET

Interest income was $226,000 for the year ended December 31, 2005, an increase of 304%as compared to $56,000 for the year ended December 31, 2004. Interest income was mainly due to $152,000 (67% of total interest income) of PacificNet Communications from lending and fixed-rate bank deposits ($2,039,000), to $45,000 of PacificNet Strategic Investment Holdings Limited from bank deposits ($362,000).

Interest expense was $144,000 for the year ended December 31, 2005, an increase of 16% as compared to $124,000 for the year ended December 31, 2004. Interest expenses were greatly derived from bank loans ($108,000) and bank overdraft ($943,000) by Epro which generated $97,000 interest expense, as a percentage of 67% of the total interest expense.

SUNDRY INCOME/EXPENSE

Sundry income known as non-operating income is defined as the external income (miscellaneous income) that results from factors outside of our operating subsidiaries' control and such income does not related to each subsidiaries' core operating business. Income from the sale of various investments is one of the typical examples. (See Note 11 for details)

For the year ended December 31, 2004, the non-operating income or sundry income was $521,000 included in Statement of Operations was mainly derived from Linkhead's consulting services income from system integration services totaling $345,000, from PacificNet Communications' Investment income totaling $55,000, from leasehold income totaling $104,000 and from others totaling $17,000.

For the year ended December 31, 2005, the non-operating income or sundry income was $655,000 included in Statement of Operations was mainly derived from the consulting services income of $368,000, investment income of $260,000, leasehold income of $6,000 and various others totaling $(21,000).

INCOME TAXES

The income taxes expenses for the Company's subsidiaries were $272,000 and $106,000 for the years ended December 31, 2005 and 2004 respectively. The provision of income taxes was the result of the operating profit generated by Epro ($631,899), Smartime ($53,243) and ChinaGoHi ($648,266), from which the income taxes amounted to $27,000, $15,000 and $195,000 respectively. Pursuant to the PRC Income Tax Laws, the Company's subsidiaries and VIEs are generally subject to Enterprise Income Taxes ("EIT") at a statutory rate of 33%, which comprises 30% national income tax and 3% local income tax. Some of these subsidiaries and VIEs are qualified new technology enterprises and under PRC Income Tax Laws, they are subjected to a preferential tax rate of 15%. Guangzhou3G-DE as software enterprise comprises 15% tax rate for one year during 2005 and it can continue to apply 15% tax rate after this is expired. In addition, Guangzhou 3G-WOFE, as a new High Technology Foreign Investment Enterprises and under PRC Income Tax Laws, is entitled to a two-year tax exemption in 2005 and 2006. In order to improve the technology market in China, another of our high-tech subsidiaries, Linkhead, is entitled a three-year tax exemption followed by three years with a 50% reduction in the tax rate, commencing the first operating year. Therefore, Linkhead's taxes have been remitted during January 1, 2003 to December 31, 2005 but it pays taxes at 7.5% from January 1, 2006 to December 31, 2008.

MINORITY INTERESTS

Minority interests for the years ended December 31, 2005 and 2004 totaled $2,132,000 and $1,271,000 respectively. Minority interests represented the interests of third parties in our subsidiaries' results.

NET LOSS

Net loss for the year ended December 31, 2005 was $5,145,000 as compared to net loss of $5,425,000 for the year ended December 31, 2004. Net loss of $(585,000), $(1,440,000) and $113,000 was generated from the Company's three business units: (1) CRM Outsourcing Services, (2) Value-Added Services (VAS) and (3) Telecom Distribution Services, represented a decrease of 17 %, 28 % and (76) % respectively as compared to $(705,000), $(1,988,000) and $480,000 respectively for the year ended December 31, 2004.

CONTRACTUAL OBLIGATIONS

CONTRACTUAL OBLIGATIONS

We have significant cash resources to meet our contractual obligations as of December 31, 2005, as detailed bellows (in thousands of US Dollars):

Payments Due by Period

Contractual Obligations

(in thousands)	Less than 1 year Restated	1-5 years Restated	After 5 years Restated	Total Restated
Line of credit	$ 1,059	0	0	$ 1,059
Bank Loans	$ 188	$ 6	0	$ 194
Operating leases	$ 571	$ 1,444	0	$ 2,015
Capital leases	$ 126	$ 78	0	$ 204
Total cash contractual obligations	$ 1,944	1,528	0	$ 3,472

OFF-BALANCE SHEET ARRANGEMENTS

We had no outstanding derivative financial instruments, off-balance sheet guarantees, interest rate swap transactions or foreign currency forward contracts. We did not engage in trading activities involving non-exchange traded contracts during 2005.

LIQUIDITY AND CAPITAL RESOURCES

WORKING CAPITAL

The Company's working capital increased by 9% to $17,109,000 for the year ended December 31, 2005 as compared to $15,646 at December 31, 2004. The increase in working capital primarily resulted from proceeds (shown net of offering costs) from our private placement activities that resulted in an increase of $1,105,000in cash balance and time deposit, net of cash expenditures for operations and acquisitions.

ISSUANCE OF COMMON STOCK

During the year ended December 31, 2005, the Company issued shares of common stock as follows: (i) 676,000 shares of common stock were issued as a result of the exercise of stock options and warrants with cash consideration of $966,000 in the aggregate;; (ii) 515,900 for the acquisition of subsidiaries with market value of $3,971,000; and (iii) 20,000 shares of common stock were issued to our investor relations firm for services rendered with a market value of $63,000.

FUTURE LIQUIDITY NEEDS

As of December 31, 2005, we had approximately $10,639,000 in cash. We regularly review our cash funding requirements and attempt to meet those requirements through a combination of cash on hand; cash provided by operations, available borrowings under bank lines of credit and possible future public or private equity offerings. We evaluate possible acquisitions of, or investments in, businesses that are complementary to ours, which transactions

may require the use of cash. We believe that our cash, other liquid assets, operating cash flows, credit arrangements, access to equity capital markets, taken together, provide adequate resources to fund ongoing operating expenditures. In the event that they do not, we may require additional funds in the future to support our working capital requirements or for other purposes and may seek to raise such additional funds through the sale of public or private equity as well as from other sources.

INFLATION

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

CURRENCY EXCHANGE FLUCTUATIONS

All of the Company's revenues are denominated either in U.S. dollars or Hong Kong dollars, while its expenses are denominated primarily in Hong Kong dollars and Chinese renminbi ("RMB"). The value of the RMB-to-U.S. dollar or Hong Kong dollar-to-United States dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. Since 1994, the conversion of renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's inter-bank foreign exchange market rates and current exchange rates on the world financial markets. Since 1994, the official exchange rate generally has been stable. Since October 2004, the renminbi has been pegged to the US dollar at the rate of one dollar for 8.2765 Yuan, which was scrapped when the renminbi reform was launched on July 21 and since then the Yuan was fixed at a market basket of currencies. Recently there has been increased political pressure on the Chinese government to decouple the renminbi from the United States dollar. At the recent quarterly regular meeting of People's Bank of China, its Currency Policy Committee affirmed the effects of the reform on Chinese renminbi exchange rate, regarding that in the past two months (February and March 2006) when the new currency rate system has been operating, the currency rate of renminbi has become more flexible while basically maintaining stable and the expectation for a larger appreciation range is shrinking. Although a devaluation of the Hong Kong dollar or renminbi relative to the United States dollar would likely reduce the Company's expenses (as expressed in United States dollars), any material increase in the value of the Hong Kong dollar or renminbi relative to the United States dollar would increase the Company's expenses, and could have a material adverse effect on the Company's business, financial condition and results of operations. For fluctuations in period to period exchange rates, the translation adjustment is required to translate from local functional currency to the USD reporting currency (not RMB to HKD to USD). The Company has never engaged in currency hedging operations and has no present intention to do so.

CONCENTRATION OF CREDIT RISK

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

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

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

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

* A substantial portion of the operations of business operations depend on mobile telecommunications operators (operators) in China and any loss or deterioration of such relationship may result in severe disruptions to their business operations and the loss of a significant portion of the Company's revenue. The VIEs rely entirely on the networks and gateways of these operators to provide its wireless value-added services. Specifically these operators are the only entities in China that have platforms for wireless value-added services. The Company's agreements with these

operators are generally for a period of less than one year and generally do not have automatic renewal provisions. If neither of them is willing to continue to cooperate with the Company, it would severely affect the Company's ability to conduct its existing wireless value-added services business.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) consists of net earnings and other gains (losses) affecting stockholders' equity that, under generally accepted accounting principles are excluded from net earnings in accordance with Statement of Financial Accounting Standards ("SFAS") 130, Reporting Comprehensive Income. Additionally, the translation adjustment is recorded as component of comprehensive income (loss) in stockholders' equity section of balance sheet.

SEASONALITY AND QUARTERLY FLUCTUATIONS

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

ITEM 7. FINANCIAL STATEMENTS

The consolidated financial statements and the report and notes, are attached hereto following the signature page beginning on Page F-1.

INDEX TO FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets-Restated - As of December 31, 2005 and 2004	F-2
Consolidated Statements of Operations-Restated - For the Years Ended December 31, 2005, December 31, 2004	F-3
Consolidated Statements of Changes in Stockholders' Equity-Restated - For the Years Ended December 31, 2005 and December 31, 2004	F-4
Consolidated Statements of Cash Flows-Restated - For the Years Ended December 31, 2005 and December 31, 2004	F-5
Notes to Consolidated Financial Statements	F-6

ITEM 8A. CONTROLS AND PROCEDURES

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

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

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT

Set forth below are the names of the directors, executive officers and significant employees of the Company as of October 24, 2007:

Name	Age	Title
Tony Tong	38	Chairman and Chief Executive Officer
Victor Tong	36	President, Secretary, and Director
Daniel Lui	43	Chief Financial Officer
ShaoJian (Sean) Wang	41	Director
Michael Ha	36	Independent Director (2) (3)
Jeremy Goodwin	33	Independent Director (1) (3)
Tao Jin	38	Independent Director (1) (2) (3)
Mike Fei	38	Company Secretary and General Counsel
Ho-Man Poon	34	Independent Director

(1) Member of Audit Committee
(2) Member of Nominating Committee
(3) Member of Compensation Committee

Our executive officers are appointed at the discretion of our board of directors with no fixed term. There are no family relationships between or among any of our executive officers or our directors other than the relationship between Mr. Tony Tong and Mr. Victor Tong.

The following is a brief description of each board of director, key positions and brief biography:

MR. TONY TONG, age 38, is the Chairman, CEO, Executive Director, and co-founder of PacificNet since 1999. From 1995 to 1997, Mr. Tong served as the Chief Information Officer of DDS Inc., a leading SAP-ERP consulting company in the USA, which was later acquired by CIBER, Inc. (NYSE: CBR). From 1993 to 1994, Mr. Tong worked for Information Advantage, Inc. (NASDAQ:IACO), a leading business intelligence, Data-Mining and CRM technology provider serving Fortune 500 clients. IACO consummated an IPO on NASDAQ in 1997 and was later acquired by Sterling Software and Computer Associates (NYSE:CA). From 1992 to 1993, Mr. Tong worked as a Business Process Re-engineering Consultant at Andersen Consulting (now Accenture, NYSE:ACN). From 1990 to 1991, Mr. Tong worked for ADC Telecommunications (NASDAQ:ADCT), a global supplier of telecom equipment. Mr. Tong's R&D achievements include being the inventor and patent holder of US Patent Number 6,012,066 (granted by US Patent and Trademark Office) titled "Computerized Work Flow System, an Internet-based workflow management system for automated web creation and process management." Mr. Tong also serves on the board of advisors of Fortune Telecom (listed on Hong Kong Stock Exchange: 0110.HK), a leading distributor of mobile phones, PDAs, telecom services, and accessories in China and Hong Kong. Mr. Tong is a frequent speaker on

technology investment in China, and was invited to present at the Fourth APEC International Finance & Technology Summit in 2001. Mr. Tong is the Vice Chairman (PRC) of Hong Kong Call Centre Association, a Fellow of Hong Kong Institute of Directors, a consultant on privatization and securitization for China's State-owned Assets Supervision and Administration Commission (SASAC), and a frequent speaker for LexisNexis, a licensed Continued Professional Development (CPD) trainer, on China investment. Mr. Tong graduated with Bachelor of Mechanical/Industrial Engineering Degree from the University of Minnesota and served on the Computer Engineering Department Advisory Board and was an Adjunct Professor at the University of Minnesota, USA. Tony Tong is the brother of Victor Tong.

MR. VICTOR TONG, age 36, is the President, Secretary, and Director of PacificNet, and has served on our board as an Executive Director since 2002. Mr. Victor Tong gained his consulting, systems integration, and technical expertise through his experience at Andersen Consulting (now Accenture, NYSE:ACN), American Express Financial Advisors (IDS), 3M, and the Superconductivity Center at the University of Minnesota. In 1994, Victor co-founded Talent Information Management ("TIM"), a leading internet application development and consulting company in Minnesota. PacificNet.com was originally founded as an operating division of TIM. In 1997, Mr. Tong successfully sold GoWeb internet consulting division of TIM to Key Investment, a leading technology and media investment company owned by Vance Opperman, a billionaire in Minnesota who founded West Publishing. Mr. Tong became the President of KeyTech, a leading information technology consulting company based in Minnesota. In 1999, he was recognized in "City Business 40 Under 40" as one of the future business and community leaders in Minnesota. Mr. Tong won the Student Commencement Speaker Award and graduated with honors with a Bachelor of Science in Physics from the University of Minnesota. Mr. Tong was an adjunct professor at the College of Software of Beihang University, one of the top software colleges in China. Victor Tong is the brother of Tony Tong.

MR. DANIEL LUI, age 43, has served as Chief Financial Officer since March 1, 2007. Mr. Lui joined PacificNet with over 17 years of professional and commercial accounting experience, 7 years of which was in Mainland China. He carries the credentials of Chartered Accountant (Alberta, Canada) and CPA-inactive (Washington, USA). Mr. Lui was Vice President of Finance and Company Secretary of Fiberxon Inc., a leading communications subsystem maker, where he was in charge of Fiberxon's Finance, Company Secretarial, and Information Technology departments from 2002 to 2007. Prior to joining Fiberxon, Mr. Lui was Chief Financial Officer of China Motion NetCom Ltd., a wholly owned subsidiary of China Motion Telecom International Limited, a Hong Kong Exchange listed company, engaged in long distance call resale business from 2000 to 2001. Prior to that, Mr. Lui was Financial Advisory Services Manager of PricewaterhouseCoopers and Auditor at KPMG. Mr. Lui received his Bachelors of Business Administration degree from the University of Hawaii at Manoa in 1987 and Masters of Business Administration from University of Alberta in Canada in 1994.

MR. SHAOJIAN (SEAN) WANG, age 41, has served on our board as a Director since 2002. From 2002 to May 2006, Mr. Wang also served as Chief Financial Officer of PacificNet. Mr. Wang is now President and Chief Operating Officer of Hurray! Holding Co., Ltd. (NASDAQ:HRAY), a NASDAQ-listed Chinese VAS company. Previously, Mr. Sean Wang was COO and acting Chief Financial Officer (CFO) at GoVideo and Opta Corporation, a public listed consumer Electronics Company in the US controlled by TCL, a leading consumer electronics maker in China. From 1987 to 2002, he served as a country manager at Ecolab, Inc. and as the managing director at Thian Bing Investments PTE, Ltd. From 1993 to 2002, Mr. Wang served as managing director of Thian Bing Investments PTE, Ltd. where he managed the Singapore-based company's multi-million dollar investment operations and identified strategic and investment opportunities. Mr. Sean Wang attended Peking University and received a BS in Economics from Hamline University and an MBA from Carlson School of Management, University of Minnesota.

MR. MICHAEL CHUN HA, age 36, has served on our board as an Independent Director since December 24, 2003. Mr. Ha graduated from the Faculty of Law, University of Hong Kong in 1994 with a bachelor degree in law and was admitted as a solicitor of the High Court of the Hong Kong Special Administrative Region in 1997 and a solicitor of the Supreme Court of England and Wales in 1998. From 1995 to 2002, Mr. Ha worked as lawyer in a number of international and Hong Kong prestigious law firms, specializing in the areas of corporate finance, securities offerings, takeovers, cross-border mergers and acquisitions, venture capital, corporate restructuring, regulatory and compliance issues, project finance, and general commercial transactions and services in Hong Kong and the People's Republic of Hong Kong. In 2002, Mr. Ha commenced his own practice in the trade name of "Ha and Ho Solicitors" and the firm specializes in the areas of general commercial transactions, corporate finance and civil and criminal litigations. Mr. Ha is also the company secretary of, Shanxi Central Pharmaceutical International Company Limited, a Hong Kong main board listed company from year 2000 and a director of a private investment company, Metro Concord Investment Limited, from year 2002.

17

MR. JEREMY GOODWIN, age 33, has served on our board as an Independent Director since December 24, 2004. Jeremy Goodwin is founder of China Diligizer and Managing Partner of 3G Capital Partners. He began his career in 1995 at Mees Pierson Investment Finance S.A. in Geneva, Switzerland where he supported the fund's private placement/private equity finance team. Noteworthy transactions executed by the group included assistance on the placements of the $1.2 Billion Carlyle Partners II Limited Partnership. In 1997 he went to work for the then parent institution, ABN Amro, in Beijing, China. In 1999, Mr. Goodwin was employed with ING Barings in London as an International Associate. Mr. Goodwin received his BS from Cornell University in 1996 in conjunction with the Institute of Higher International Studies in Geneva, Switzerland. He later pursued his advanced degree with Princeton University with a concentration in Chinese affairs which he completed at the prestigious Nanjing Chinese Studies Center of the Johns Hopkins School of Advanced International Studies. Jeremy is fluent in written and spoken Mandarin Chinese, French and has working knowledge of Dutch.

MR. TAO JIN, age 38, has served on our board as an Independent Director since January 6, 2005. Mr. Jin is a resident partner at Jun He Law Offices (www.JunHe.com), a leading Chinese law firm specializing in commercial legal practice with over 160 lawyers and offices in Beijing, Shanghai, Shenzhen, Dalian, Haikou and New York. Founded in April 1989, Jun He was one of the first private law firms formed in China, and has been a pioneer in the re-established Chinese legal profession with a focus in representing foreign clients in business activities throughout China. Over the past few years, Jun He has been honored a number of times as one of the best law firms in China by the Ministry of Justice of China. With a team of more than 160 well-trained lawyers, Jun He is one of the largest and most established law firms in China. Prior to joining Jun He, Mr. Jin served as Vice President and Assistant General Counsel of J.P. Morgan Chase Bank, as the head legal counsel for capital markets transactions in Asia, and for JPMorgan's M&A transactions in China. Mr. Jin joined Jun He as a partner in 2005. From 1999 to 2002, Mr. Jin served as a Senior New York Qualified Lawyer for Sullivan & Cromwell, which represented China Unicom, PetroChina and China Telecom in their IPO's and dual listings in New York and Hong Kong. From 1996 to 1999, Mr. Jin served as Associate Lawyer for Cleary, Gottlieb Steen & Hamilton, which represented various Fortune 500 companies and investment banks in public and private securities offerings and M&A activities. Mr. Jin received his Juris Doctor in 1996 with high honors from Columbia University, and received B.S. in Psychology in 1990 from Beijing University.

MR. MIKE FEI, age 38, is the Company Secretary and General Counsel for PacificNet. Mr. Fei joined PacificNet in 2004 as in-house PRC Chief Legal Counsel for PacificNet's China Operations. Mr. Fei is a Member of the All-China Bar Association and holds a Master of Law degree from the University of New South Wales of Australia. Mr. Fei has 8 years of experience in the legal profession and dealt with more than 200 cases of litigation and arbitration which related to the issues of foreign investment, bankruptcy, merging, commercial contract and debt disputes.

MR. HO-MAN (MIKE) POON, is a nominee for independent director of PacificNet. Mr. Poon is a Chartered Financial Analyst (CFA). He is the first session graduate of the EMBA course of the Tsinghua University and holds a Bachelor degree from the University of Hong Kong. He has been registered as dealing director and investment advisor since 2002. He has over 11 years experience in the equity and capital markets of the Greater China Region, ranging from direct investment, fund management, securities brokerage and financial advisory. He is experienced in deal structuring, especially in relation to transactions of the listed companies in Hong Kong. Since 2002, he has served as the Chairman and the Chief Executive Officer of the Friedmann Pacific group of companies, which is a private financial groups covering investment, securities brokerage and financial services. He is a member of the Hong Kong Society of Financial Analyst and the member of the Hong Kong Institute of Directors.

COMPLIANCE WITH SECTION 16(A) OF EXCHANGE ACT

Section 16(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), requires our executive officers, directors and persons who beneficially own more than 10% of a registered class of our equity securities to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our

common stock and other equity securities. Such executive officers, directors, and greater than 10% beneficial owners are required by SEC regulation to furnish us with copies of all Section 16(a) forms filed by such reporting persons.

Based solely on our review of such forms furnished to us and written representations from certain reporting persons, we believe that the following executive officers and directors failed to timely file Form 4's and 5's: Tony Tong failed to timely file Form 4's, one Form 4 reporting the exercise of a stock option and three Form 4's each reporting the grant of stock options; Victor Tong failed to timely file Form 4's, one Form 4 reporting the exercise of a stock option and four Form 4's each reporting the grant of stock options; Shaojian Wang failed to timely file Form 4's, two Form 4's each reporting the exercise of stock options and three Form 4's each reporting the grant of stock options; Michael Chun Ha failed to timely file Form 4's, one Form 4 reporting the exercise of an option and three Form 4's each reporting the grant of stock options; Peter Wang failed to timely file three Form 4's each reporting the grant of stock options; Jeremy Goodwin failed to timely file three Form 4's each reporting the grant of stock options and Tao Jin failed to timely file three Form 4's each reporting the grant of stock options.

AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

The Audit Committee is responsible for nominating the Company's independent auditors and reviewing any matters that might impact the auditors' independence from the Company; reviewing plans for audits and related services; reviewing audit results and financial statements; reviewing with management the adequacy of the Company's system of internal accounting controls, including obtaining from independent auditors management letters or summaries on such internal accounting controls; determining the necessity and overseeing the effectiveness of the internal audit function; reviewing compliance with the U.S. Foreign Corrupt Practices Act and the Company's internal policy prohibiting insider trading in its Common Stock; reviewing compliance with the SEC requirements for financial reporting and disclosure of auditors' services and audit committee members and activities; reviewing related-party transactions for potential conflicts of interest; and reviewing with corporate management and internal and independent auditors the policies and procedures with respect to corporate officers' expense accounts and perquisites, including their use of corporate assets.

The board of directors has established an audit committee in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The members of the Audit Committee are Messrs. Jeremy Goodwin and Tao Jin, each of whom are considered "independent" under the NASDAQ National Market listing standards currently in effect.

The board of directors has determined that each of the members of the audit committee qualify as an "audit committee financial expert" under the Securities and Exchange Commission's definition.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K.

EXHIBITS

The following exhibits are filed as part of this report:

EXHIBIT NUMBER	**DESCRIPTION**
2.1	Share Exchange Agreement by and among Davin Enterprises, Inc., Carl Tong, Leo Kwok and Acma trategic Holdings Limited dated December 15, 1997. (1)
2.2	Share Exchange Agreement dated February 17, 2000, between Registrant and holders of embership interests in PacificNet.com LLC.(2)
2.3	Supplement to Share Exchange Agreement dated April 29, 2000, between Registrant and holders of membership interests in PacificNet.com LLC. (2)
2.4	Agreement dated September 30, 2000, among the Company and the "Purchasers" named therein. (3)
2.5	Supplemental Agreement dated October 3, 2000, among the Company and the "Purchasers" named therein. (3)
2.6	Deed of Waiver, dated October 3, 2000, by Creative Master Limited in favor of the Company. (3)
3.1	Certificate of Incorporation, as amended. (4)
3.2	Form of Amended By Laws of the Company. (4) Specimen Stock Certificate of the Company.
4.1	Securities Purchase Agreement, dated as of January 15, 2004, among PacificNet Inc. and the purchasers identified therein (5)
4.2	Form of Common Stock Warrant issued to each of the purchasers (5)
4.3	Form of Common Stock Warrant issued to each of the purchasers, dated December 9, 2004 (10)
4.4	Form of Common Stock Warrant issued to each of the purchasers, dated November 17, 2004 (10)
4.5	Securities Purchase Agreement, dated February 28, 2006, among PacificNet Inc. and the Holders identified therein (12)
4.6	Form of Variable Rate Convertible Debenture due March 2009 issued to each of the Holders (12)
4.7	Form of Common Stock Purchase Warrant issued to each of the holders (12)
4.8	Form of Registration Rights Agreement, dated February 28, 2006 (17)
10.1	Form of Indemnification Agreement with officers and directors. (1)
10.2	Amendment to 1998 Stock Option Plan. (8)
10.3	Form of Notice of Stock Option Grant and Stock Option Agreement under the 1998 Stock Option Plan. (2)
10.4	Amendment dated January 31, 2002 to the Subscription Agreement by and between the Company and Sino Mart Management Ltd., dated as of December 9, 2001 (6)
10.6	Sub-Lease Agreement dated August 30, 2002.(8)
10.7	Agreement dated on December 1, 2003 for the Sale and Purchase and Subscription of Shares in Epro Telecom Holdings Limited (9)
10.8	Agreement dated on December 15, 2003 for the Sale and Purchase of Shares in Beijing Linkhead Technologies Co., Ltd. (9)
10.9	Securities Purchase Agreement, dated as of December 9, 2004, among PacificNet Inc. and the purchasers identified therein (10)
10.10	Securities Purchase Agreement, dated as of November 17, 2004, among PacificNet Inc. and the purchasers identified therein (10)
10.11	Agreement for the Sale and Purchase of Shares in Shanghai Classic Group Limited (4)
10.12	Agreement for the Sale and Purchase of Shares of Cheer Era Limited (11)
10.13	Agreement for the Sale and Purchase of Shares in Pacific Smartime Solutions Limited

10.14	Agreement for the Sale and Purchase of Shares in Guangzhou Clickcom Digit-net Science and Technology Ltd. (16)
10.15	PacificNet Inc. 2005 Stock Option Plan (15)
10.16	Agreement for the Sale and Purchase of Shares in GuangZhou 3G Information Technology Co.,Ltd. (16)
10.17	Agreements of Consulting, Pledge, and Power of Attorney of Clickcom and Sunroom (14)
10.18	Agreement for the Sale and Purchase of Shares in Lion Zone Holdings (13)
10.19	Form of Lock-Up Agreement, dated March 13, 2006 (17)
10.20	Form of Voting Agreement, dated March 13, 2006 (17)
14	Code of Ethics (9)
21	List of Subsidiaries (Included in Exhibit 99.1)
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 +	18 U.S. C. Section 1350 Certifications.
99.1	Corporate structure chart of our corporate and share ownership structure (14)
99.2	Subscription Agreement by and between the Company and Sino Mart Management Ltd., dated as of December 9, 2001 (6)
99.3	19.9% Private Placement Agreement and Amendments between Ho Shu-Jen and PacificNet.com Inc. (7)

+ Filed herewith.
(1) Incorporated by reference to the Company's Form SB-2 filed on October 21, 1998.
(2) Incorporated by reference to the Company's Form 8-K filed on August 11, 2000.
(3) Incorporated by reference to the Company's Form 8-K filed on October 17, 2000.
(4) Incorporated by reference to the Amendment to Registration Statement on Form S-3 on Form SB-2/A (Registration No. 333-113209) filed on April 21, 2004.
(5) Incorporated by reference to the Registration Statement on Form S-3 filed on March 2, 2004.
(6) Incorporated by reference to the Company's Form 8-K filed on March 20, 2002.
(7) Incorporated by reference to the Company's Form 10-KSB filed on April 16, 2002.
(8) Incorporated by reference to the Company's 10-KSB filed on March 31, 2003.
(9) Incorporated by referenced to the Company's Form 10-KSB filed on April 2, 2004.
(10) Previously filed as an exhibit to the Form SB-2 Registration Statement filed on December 30, 2004.
(11) Incorporated by reference to the Company's Form 8-K filed on April 19, 2004.
(12) Incorporated by reference to the Company's Form 8-K filed on March 6, 2006.
(13) Incorporated by reference to the Company's Form 8-K filed on December 20, 2005.
(14) Incorporated by reference to the Company's Form 10-KSB filed on April 28, 2006.
(15) Incorporated by reference to the Company's Definitive Proxy Statement filed on November 19, 2004.
(16) Incorporated by reference to the Company's Form 10-KSB filed on April 19, 2005.
(17) Incorporated by reference to the Company's Form 10-KSB/A filed on November 3, 2006.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

For fiscal years ended December 31, 2005 and 2004, and for the review of the financial statements included in the Company's Quarterly Reports on Form 10-QSB for fiscal years 2005 and 2004, the aggregate fees billed by our predecessor independent auditor Clancy and Co., P.L.L.C. and its Hong Kong affiliate HLB Hodgson Impey Cheng to us were $182,400 and 82,060, respectively.

AUDIT FEES

The aggregate fees paid to Kabani & Company, Inc for professional services rendered for the reaudit of the Company's annual financial statements for the fiscal years ended December 31, 2005 and 2004.

AUDIT RELATED FEES

NONE.

TAX FEES

NONE.

ALL OTHER FEES

NONE.

PRE-APPROVAL OF SERVICES

The Audit Committee pre-approves all services, including both audit and non-audit services, provided by our independent accountants. For audit services, each year the independent auditor provides the Audit Committee with an engagement letter outlining the scope of the audit services proposed to be performed during the year, which must be

formally accepted by the audit commences. The independent auditor also submits an audit services fee proposal, which also must be approved by the audit commences.

SIGNATURES

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

PACIFICNET INC.

Date: October 24, 2007

BY: /S/ TONY TONG
Tony Tong
Chief Executive Officer (Principal Executive Officer)

Date: October 24, 2007

BY: /S/ DANIEL LUI
Daniel Lui
Chief Financial Officer (Principal Financial Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ TONY TONG Tony Tong	Director, Chairman and CEO	October 24, 2007
/s/ VICTOR TONG Victor Tong	Director, President and	October 24, 2007
/s/ DANIEL LUI Daniel Lui	Chief Financial Officer	October 24, 2007
/s/ SHAO JIAN WANG Shao Jian Wang	Director	October 24, 2007
/s/ MICHAEL CHUN HA Michael Chun Ha	Director	October 24, 2007
/s/ TAO JIN Tao Jin	Director	October 24, 2007
/s/ JEREMY GOODWIN Jeremy Goodwin	Director	October 24, 2007
/s/ HO-MAN POON Ho-Man Poon	Director	October 24, 2007

EXHIBIT NUMBER	DESCRIPTION
2.1	Share Exchange Agreement by and among Davin Enterprises, Inc., Carl Tong, Leo Kwok and Acma Strategic Holdings Limited dated December 15, 1997. (1)
2.2	Share Exchange Agreement dated February 17, 2000, between Registrant and holders of membership interests in PacificNet.com LLC.(2)
2.3	Supplement to Share Exchange Agreement dated April 29, 2000, between Registrant and holders of membership interests in PacificNet.com LLC. (2)
2.4	Agreement dated September 30, 2000, among the Company and the "Purchasers" named therein. (3)
2.5	Supplemental Agreement dated October 3, 2000, among the Company and the "Purchasers" named therein. (3)
2.6	Deed of Waiver, dated October 3, 2000, by Creative Master Limited in favor of the Company. (3)
3.1	Certificate of Incorporation, as amended. (4)
3.2	Form of Amended By Laws of the Company. (4) Specimen Stock Certificate of the Company.
4.1	Securities Purchase Agreement, dated as of January 15, 2004, among PacificNet Inc. and the purchasers identified therein (5)
4.2	Form of Common Stock Warrant issued to each of the purchasers (5)
4.3	Form of Common Stock Warrant issued to each of the purchasers, dated December 9, 2004 (10)
4.4	Form of Common Stock Warrant issued to each of the purchasers, dated November 17, 2004 (10)
4.5	Securities Purchase Agreement, dated February 28, 2006, among PacificNet Inc. and the Holders identified therein (12)
4.6	Form of Variable Rate Convertible Debenture due March 2009 issued to each of the Holders (12)
4.7	Form of Common Stock Purchase Warrant issued to each of the holders (12)
4.8	Form of Registration Rights Agreement, dated February 28, 2006 (17)
10.1	Form of Indemnification Agreement with officers and directors. (1)
10.2	Amendment to 1998 Stock Option Plan. (8)
10.3	Form of Notice of Stock Option Grant and Stock Option Agreement under the 1998 Stock Option Plan. (2)
10.4	Amendment dated January 31, 2002 to the Subscription Agreement by and between the Company and Sino Mart Management Ltd., dated as of December 9, 2001 (6)
10.6	Sub-Lease Agreement dated August 30, 2002.(8)
10.7	Agreement dated on December 1, 2003 for the Sale and Purchase and Subscription of Shares in Epro Telecom Holdings Limited (9)
10.8	Agreement dated on December 15, 2003 for the Sale and Purchase of Shares in Beijing Linkhead Technologies Co., Ltd. (9)
10.9	Securities Purchase Agreement, dated as of December 9, 2004, among PacificNet Inc. and the purchasers identified therein (10)
10.10	Securities Purchase Agreement, dated as of November 17, 2004, among PacificNet Inc. and the purchasers identified therein (10)
10.11	Agreement for the Sale and Purchase of Shares in Shanghai Classic Group Limited (4)
10.12	Agreement for the Sale and Purchase of Shares of Cheer Era Limited (11)
10.13	Agreement for the Sale and Purchase of Shares in Pacific Smartime Solutions Limited
10.14	Agreement for the Sale and Purchase of Shares in Guangzhou Clickcom Digit-net Science andTechnology Ltd. (16)
10.15	PacificNet Inc. 2005 Stock Option Plan (15)

10.16	Agreement for the Sale and Purchase of Shares in GuangZhou 3G Information Technology Co.,Ltd. (16)
10.17	Agreements of Consulting, Pledge, and Power of Attorney of Clickcom and Sunroom (14)
10.18	Agreement for the Sale and Purchase of Shares in Lion Zone Holdings (13)
10.19	Form of Lock-Up Agreement, dated March 13, 2006 (17)
10.20	Form of Voting Agreement, dated March 13, 2006 (17)
14	Code of Ethics (9)
21	List of Subsidiaries (Included in Exhibit 99.1)
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 +	18 U.S.C Section 1350 Certifications
99.1	Corporate structure chart of our corporate and share ownership structure (14)
99.2	Subscription Agreement by and between the Company and Sino Mart Management Ltd., dated as of December 9, 2001 (6)
99.3	19.9% Private Placement Agreement and Amendments between Ho Shu-Jen and PacificNet.com Inc. (7)

+ Filed herewith.
(1) Incorporated by reference to the Company's Form SB-2 filed on October 21, 1998.
(2) Incorporated by reference to the Company's Form 8-K filed on August 11, 2000.
(3) Incorporated by reference to the Company's Form 8-K filed on October 17, 2000.
(4) Incorporated by reference to the Amendment to Registration Statement on Form S-3 on Form SB-2/A (Registration No. 333-113209) filed on April 21, 2004.
(5) Incorporated by reference to the Registration Statement on Form S-3 filed on March 2, 2004.
(6) Incorporated by reference to the Company's Form 8-K filed on March 20, 2002.
(7) Incorporated by reference to the Company's Form 10-KSB filed on April 16, 2002.
(8) Incorporated by reference to the Company's 10-KSB filed on March 31, 2003.
(9) Incorporated by referenced to the Company's Form 10-KSB filed on April 2, 2004.
(10) Previously filed as an exhibit to the Form SB-2 Registration Statement filed on December 30, 2004.
(11) Incorporated by reference to the Company's Form 8-K filed on April 19, 2004.
(12) Incorporated by reference to the Company's Form 8-K filed on March 6, 2006.
(13) Incorporated by reference to the Company's Form 8-K filed on December 20, 2005.
(14) Incorporated by reference to the Company's Form 10-KSB filed on April 28, 2006.
(15) Incorporated by reference to the Company's Definitive Proxy Statement filed on November 19, 2004.
(16) Incorporated by reference to the Company's Form 10-KSB filed on April 19, 2005.
(17) Incorporated by reference to the Company's Form 10-KSB/A filed on November 3, 2006.

INDEX TO FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets-Restated - As of December 31, 2005 and 2004	F-2
Consolidated Statements of Operations-Restated - For the Years Ended December 31, 2005, and December 31, 2004	F-3
Consolidated Statements of Changes in Stockholders' Equity-Restated - For the Years Ended December 31, 2005, and December 31, 2004	F-4
Consolidated Statements of Cash Flows-Restated - For the Years Ended December 31, 2005, and December 31, 2004	F-5
Notes to Consolidated Financial Statements	F-6

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Pacific Net Inc.

We have audited the accompanying consolidated balance sheets of PacificNet Inc. (a Delaware Corporation) and Subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards established by the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PacificNet Inc. and Subsidiaries as of December 31, 2005 and 2004, and the results of their consolidated operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As disclosed in note 15 to the consolidated financial statements, subsequent to December 31, 2005, the Company acquired and disposed off several significant subsidiaries and also, is subject to several lawsuits. As disclosed in note 15 to the consolidated financial statements, subsequent to the year ended December 31, 2005, the Company suspended use of the prospectus contained in its Registration Statement on Form S-1 that was declared effective on December 8, 2006. 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.

As discussed in Note 16, the financial statements for the two years ended December 31, 2005 and 2004 have been restated.

/s/ KABANI & COMPANY, INC.

LOS ANGELES, CA
September 23, 2007.

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS--RESTATED
AS AT DECEMBER 31, 2005 AND 2004
(In thousands of United States dollars, except par values and share numbers)

	2005	2004
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 10,639	$ 9,534
Restricted cash - pledged bank deposit	163	212
Accounts receivables, net of allowances for doubtful accounts	6,869	5,575
Inventories	1,987	1,250
Loan receivable from related parties	2,328	1,460
Loan receivable from third parties	1,062	38
Marketable equity securities - available for sale	539	29
Other current assets	5,197	1,609
Total Current Assets	28,784	19,707
Property and equipment, net	3,687	721
Investments in affiliated companies and subsidiaries	1,161	1,933
Goodwill	9,129	7,636
Other assets	235	-
TOTAL ASSETS	**$ 42,996**	**$ 29,997**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Bank line of Credit	$ 1,059	$ 196
Bank loans-current portion	188	1,577
Capital lease obligations - current portion	126	99
Accounts payable	1,146	1,054
Accrued expenses and other payables	8,007	951
Income tax payable	390	-
Loan payable to related party	759	184
Total Current Liabilities	11,675	4,061
Bank loans - noncurrent portion	6	70
Capital lease obligations - noncurrent portion	78	110
Total long-term liabilities	84	180
Total liabilities	**11,759**	**4,241**
Minority interest in consolidated subsidiaries	8,033	1,648
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:		
December 31, 2005: 12,000,687 issued, 10,809,562 outstanding		
December 31, 2004: 10,627,737 issued, 9,794,121 outstanding	1	1
Treasury stock, at cost (2005: 1,191,125 shares; 2004: 833,616 shares)	(134)	(119)

Additional paid-in capital	61,979	57,730
Cumulative other comprehensive income	(15)	(22)
Accumulated deficit	(38,627)	(33,482)
Total Stockholders' Equity	23,204	24,108
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 42,996**	**$ 29,997**

The accompanying notes form an integral part of these consolidated financial statements

F-2

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS - RESTATED
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(In thousands of United States dollars, except loss per share and share amounts)

	2005	2004
Net Revenues		
Services	$ 21,082	$ 10,008
Product sales	10,004	6,934
Total net revenue	31,086	16,942
Cost of Revenues		
Services	12,584	7,046
Product sales	8,094	5,240
Total cost of revenue	20,678	12,286
Gross Profit	10,408	4,656
Operating expenses:		
Selling, General and Administrative expenses	(10,419)	(5,267)
Stock-based compensation expenses	(282)	(1,246)
Depreciation and amortization	(351)	(103)
Impairment of Goodwill	(3,689)	(2,628)
Total Operating expenses	(14,741)	(9,244)
Loss from operations	(4,333)	(4,588)
Other income (expenses):		
Interest income/(expense), net	82	(68)
Sundry income, net	655	521
Total other income	737	453
Loss from operations before Income Taxes and Minority Interests	(3,596)	(4,135)
Provision for income taxes	(272)	(106)
Share of earnings from investment on equity method	855	87
Minority Interests	(2,132)	(1,271)
NET LOSS	(5,145)	(5,425)
Other comprehensive income (loss):		
Foreign exchange gain (loss)	7	(22)
Net comprehensive loss	**$ (5,138)**	**$ (5,447)**
BASIC & DILUTED LOSS PER COMMON SHARE:		
Loss per common share – basic & diluted	$ (0.51)	$ (0.78)
*Weighted average number of shares - basic & diluted	10,156,809	7,015,907

*Weighted average number of shares used to calculate basic and diluted loss per share are considered same as the effect of dilutive shares is anti-dilutive.

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

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY--RESTATED
(In thousands of United States dollars, except number of shares)

	Common Stock (Outstanding)		Additional Paid-in Capital	Cumulative Other Comprehensive Income/(loss)	Accumulated Deficit (Restated)	Treasury Stock		Total Stockholders' Equity (Restated)
	Shares	Amount				Shares	Amount	
Balance at December 31, 2003, as restated	**5,363,977**	**$ 1**	**$ 31,790**	**$ (24)**	**$ (28,056)**	**800,000**	**$ (5)**	**$ 3,706**
Issuance of common stock for acquisition of subsidiaries	1,756,240	-	9,938	-	-	-	-	9,938
Proceeds from the sale of common stock, net of related costs	2,205,697	-	12,330	-	-	-	-	12,330
PIPE related Expenses	-	-	(205)	-	-	-	-	(205)
Issuance of common stock for acquisition of affiliate	149,459	-	1,547	-	-	-	-	1,547
Repurchase of common stock	(33,616)	-	-	-	-	33,616	(114)	(114)
Stock issued for services	50,000	-	132	-		-	-	132
Stock issued in error	83,000	-	-	-	-	-	-	-
Stock options expense	-	-	1,246	-	-	-	-	1,246
Exercise of stock options and warrants for cash	219,364	-	606	-	-	-	-	606
Foreign currency translation gain	-	-	-	2	-	-	-	2
Excess finders fee charged adjusted	-	-	345	-	-	-	-	345
Net loss	**-**	**-**	**-**	**-**	**(5,425)**	**-**	**-**	**(5,425)**
Balance at December 31, 2004	**9,794,121**	**1**	**57,730**	**(22)**	**(33,482)**	**833,616**	**(119)**	**24,108**
Issuance of common stock for acquisition of subsidiaries	515,900	-	3,971	-	-	-	-	3,971
Stock issued for services	20,000	-	63	-	-	-	-	63
Repurchase of common stock for	(149,459)	-	(1,547)	-	-	149,459	-	(1,547)

acquisition of affiliate								
Cancellation of common stock	(45,000)	-	-	-	-	45,000	-	-
Repurchase of common shares	(2,000)	-	-	-	-	2,000	(15)	(15)
Stock options expense	-	-	282	-	-	-	-	282
Exercise of stock options and warrants for cash	676,000	-	966	-	-	-	-	966
Holdback shares as contingent consideration due to performance targets not yet met	-	-	-	-	-	298,550	-	-
Share consideration for acquisition of subsidiary deemed issued under S&P	-	-	-	-	-	(137,500)	-	-
Excess finders fee charged adjusted	-	-	455	-	-	-	-	455
Option exercise price adjusted	-	-	60	-	-	-	-	60
Foreign currency translation gain	-	-	-	7	-	-	-	7
Net loss	**-**	**-**		**-**	**(5,145)**	**-**	**-**	**(5,145)**
BALANCE AT DECEMBER 31, 2005	**10,809,562**	**$ 1**	**$ 61,979**	**$ (15)**	**$ (38,627)**	**1,191,125**	**$ (134)**	**$ 23,204**

The accompanying notes form an integral part of these consolidated financial statements

F-4

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

	For the Years Ended December 31,	
Cash Flows from operating activities	**2005 Restated**	**2004 Restated**
Net loss	$ (5,145)	$ (5,425)
Adjustment to reconcile net loss to net cash provided by (used in) operating activities:		
Provision for allowance for doubtful accounts	3,425	777
Minority Interest	2,132	1,271
Depreciation and amortization	2,109	139
Goodwill impairment	3,689	2,628
Stock-based compensation	282	1,246
Issuance of shares for services	63	132
Realized income (loss) on marketable securities		
Changes in current assets & liabilities net of effects from purchase of subsidiaries:		
Accounts receivable and other current assets	1,243	(4,842)
Inventories	(737)	(1,174)
Accounts payable and accrued expenses	(4,782)	2,491
Net cash provided by (used in) operating activities	**11,843**	**(2,757)**
Cash flows from investing activities		
Increase in restricted cash	49	-
Increase in purchase of marketable securities	(510)	(29)
Acquisition of property and equipment	(5,365)	(477)
Acquisition of subsidiaries and affiliated companies	(3,958)	(991)
Repurchase of treasury shares	(15)	(114)
Net cash used in investing activities	**(9,799)**	**(1,611)**
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES:		
Loans receivable from third parties	(1,024)	(38)
Loans receivable from related parties	(868)	(1,460)
Loans payable to related party	575	184
Advances (repayments) under bank line of credit	863	(1,003)
Repayment of amount borrowed under capital lease obligations	(5)	(92)
Proceeds from exercise of stock options and warrants	966	496
Advances under bank loans	(1,453)	(135)
Payment of certain PIPE related expenses	-	(205)
Proceeds from sale of common stock for cash	-	12,330
Net cash provided by (used in) financing activities	**(946)**	**10,077**
Effect of exchange rate change on cash and cash equivalents	7	2
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**1,105**	**5,710**

CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		**9,534**		**3,823**
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$**	**10,639**	**$**	**9,534**
SUPPLEMENTAL CASH FLOW INFORMATION:				
Interest paid	$	229	$	178
Income taxes paid	$	(53)	$	3
NONCASH INVESTING AND FINANCING ACTIVITIES:				
Investment in subsidiaries and affiliate through issuance of common stock	$	3,971	$	9,938

The accompanying notes form an integral part of these consolidated financial statements

F-5

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

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

PacificNet Inc. (referred to herein as "PacificNet" or the "Company") was originally incorporated in the State of Delaware on April 8, 1987. Through our subsidiaries we provide outsourcing services, value-added telecom services (VAS) and communication products distribution services. Our business process outsourcing (BPO) services include call centers, providing customer relationship management (CRM), and telemarketing services, and our information technology outsourcing (ITO) includes software programming and development. We are value-added resellers and providers of telecom VAS, which is comprised of interactive voice response (IVR) systems, call center management systems, and voice over Internet protocol (VOIP), as well as mobile phone VAS, such as short messaging services (SMS) and multimedia messaging services (MMS). The Company's operations are primarily targeted in the China and Hong Kong market.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America and present the financial statements of the Company and its wholly owned and majority-owned subsidiaries including variable interest entities ("VIEs") for which the Company is the primary beneficiary. All significant inter-company accounts and transactions have been eliminated. Investments in entities in which the Company can exercise significant influence, but which are less than majority owned and not otherwise controlled by the Company, are accounted for under the equity method.

The Company has adopted FASB Interpretation No. 46R "Consolidation of Variable Interest Entities" ("FIN 46R"), an Interpretation of Accounting Research Bulletin No. 51. FIN 46R requires a Variable Interest Entity (VIE) to be consolidated by a company if that company is subject to a majority of the risk of loss for the VIE or is entitled to receive a majority of the VIE's residual returns. VIEs are those entities in which the Company, through contractual arrangements, bears the risks of, and enjoys the rewards normally associated with ownership of the entities, and therefore the company is the primary beneficiary of these entities. Acquisitions of subsidiaries or variable interest entities are accounted for using the purchase method of accounting. The results of subsidiaries or variable interest entities acquired during the year are included in the consolidated income statements from the effective date of acquisition.

INITIAL MEASUREMENT OF VIE- The Company initially measures the assets, liabilities, and non-controlling interests of the VIEs at their fair values at the date of the acquisitions. Goodwill is recorded for the excess of the fair value of the newly consolidated assets and the reported amount of assets transferred by the primary beneficiary to the VIE over the sum of the fair value of the consideration paid, the reported amount of any previously held interests, and the fair value of the newly consolidated liabilities and non-controlling interests are allocated and reported as a pro rata adjustment of the amounts that would have been assigned to all of the newly consolidated assets as if the initial consolidation had resulted from a business combination

---

ACCOUNTING AFTER INITIAL MEASUREMENT OF VIE - Subsequent accounting for the assets, liabilities, and non-controlling interest of a consolidated variable interest entity are accounted for as if the entity were consolidated based on voting interests and the usual accounting rules for which the VIE operates are applied as they would to a consolidated subsidiary as follows:

- Carrying amounts of the VIE are consolidated into the financial statements of PacificNet as the primary beneficiary (referred as "Primary Beneficiary" or "PB")

- Inter-company transactions and balances, such as revenues and costs, receivables and payables between or among the Primary Beneficiary and the VIE(s) are eliminated in their entirety

- There is no direct ownership interest by the Primary Beneficiary in the VIE, equity of the VIE is eliminated with an offsetting credit to minority interest

PRC laws and regulations restrict us, as a foreign entity, from having a direct controlling interest in entities such as Guangzhou Dianxun Co., Ltd.(Dianxun-DE) and Guangzhou Sunroom Information Industry Co., Ltd.(Sunroom-DE) that hold operating licenses to engage in domestic telecom value-added services and online ecommerce in China. As a result, we conduct substantially all of our operations through Guangzhou Clickcom Digit-net Science(WOFE)and Technology Ltd. and Guangzhou 3G Information Technology Co., Ltd.(WOFE). We own 51% of the shares in each of the WOFEs and each WOFE signed Consulting and Services Agreements with Dianxun-DE and Sunroom-DE (the entities that actually carry out the operating activities). These agreements provide that all of the DE profits will flow through to the respective WOFEs. Pursuant to these agreements, the Company guarantees any obligations undertaken by these companies under their contractual agreements with third parties, and the Company is entitled to receive service fees in an amount equal to 51% of the net income of these companies. Accordingly, we bear the risks of, and enjoy the rewards associated with, the investments in the WOFEs.

The operations of DEs are managed by their original management teams, however, the Company has the power to appoint or change directors and senior management because it indirectly ultimately controls the voting power of the shareholders of each DE through the Power of Attorney given to PacificNet's President according to the operating agreements between the DEs and WOFEs. Pursuant to the Consulting and Service Agreements signed between each WOFE and their respective DE, the WOFE ("Party A") agrees to be the exclusive provider of telecom consulting services to the DE ("Party B"). During the term of the agreement, Party B shall not accept technical and consulting services provided by any third party. Party B agrees to pay a fee to Party A equal to 100% of its monthly net income for the services provided. Payment of the service fees has been secured through a share pledge agreement with the shareholders of each of the DEs, whereby they pledged all of their shares to the respective WOFE. Further,

(1) Each of the DEs, by design, is thinly capitalized because a substantial portion of PacificNet's invested amounts or consideration were paid or payable directly to previous owners of Sunroom-DE and Dianxun-DE for entering into the acquisition transactions while none of the investment consideration was injected into the DEs. Therefore, additional funding from PacificNet is needed to support the DEs' business development and working capital.

(2) Fees from Service Contracts are substantial, but are not commensurate with the level of service provided by the WOFEs to the DEs. The contractual and funding arrangements with the DEs evidence that PacificNet has closely participated in the majority of the DEs' economics. PacificNet is the primary beneficiary through its WOFE subsidiaries since PacificNet is the only enterprise with a sufficiently large interest in the VIEs. In compliance with PRC's foreign investment restrictions on Internet Content Provider and Value Added Telecom Services Provider's laws and regulations, the Company conducts all of its value-added services for telecom in China via the following significant domestic VIEs below. The respective management agreements between the VIE's and WOFE's create a variable interest and accordingly, these two Vies are consolidated as VIE through their respective WOFEs from the

date of acquisition.

The following is a summary of all the VIEs of the Company:

GuangZhou DianXun Company Limited (the "Dianxun-VIE"), a China company controlled through business agreement. Through Dianxun-VIE, a variable interest entity, PacificNet is able to provide indirectly to China's telecom operators, a wide variety of wireless Internet services for mobile phones, such as SMS, Wireless Application Protocol, or WAP, which allows users to access information instantly via handheld wireless devices, and Java mobile applications. The business of the VIE is managed by their original management teams. Clickcom VIE is owned by Zhang Ming, CEO 60%, Lai Jinnan, COO 30%, Liu Dong, CTO 10% of the Company. The adjusted registered capital of the VIE is $125,000 (the original registered capital of Dianxun-VIE was approx. US$1.25m but was adjusted down to reflect the fair value of NAV at time of acquisition. (See Note 5) The VIE's board of directors has the power to appoint the General Manager of the VIE who in turn has the power to appoint other members of the management. PacificNet does not directly participate in the daily operation of the VIE. It however has the power to change the management, if needed, because PacificNet is directly or indirectly controlling the board of this VIE. As at the December 31, 2005, Dianxun-VIE's revenues and net earnings accounted for approximately 2% and 3% of our consolidated revenues and net earnings before minority interests respectively.

Guangzhou Sunroom Information Industrial Co., Ltd. ("Sunroom-VIE"), a PRC registered domestic enterprise, controlled by PacificNet through a series of contractual agreements. It is responsible for VAS in China under its ICP and VAS licenses. It is 31% owned by Mr. Wang Yongchao (CEO), 41.4% owned by Mr. Liao Mengjiang (COO) and 27.6% owned by non-participating shareholder, Mr. Sun Zhengquan. The registered capital of the VIE Company is $4.0 million. Sunroom-VIE is required to transfer their ownership in these entities to our subsidiaries when permitted by PRC laws and regulations and all voting rights are assigned to us. As at December 31, 2005, Sunroom-VIE's revenues and net loss accounted for approximately 17% and (96)% of our consolidated revenues and net earnings before minority interests, respectively.

The initial capital investments in these VIEs were not funded by us but we have provided loans to these VIEs to fund their R&D and expansion plans. As of December 31, 2005, the amount of loans to Clickcom VIE and Sunroom VIE were approximately US$262,695 (low interest at 2%) and US$246,216 (interest free) respectively. None of the VIEs' assets were collateralized for our loans. Given the fact that we do not have direct ownership interests in these VIEs, the creditors of these VIEs will not have recourse to the general credit of our group being the primary beneficiary.

Under various contractual agreements, employee shareholders of the VIEs are required to transfer their ownership in these entities to our subsidiaries in China when permitted by PRC laws and regulations or to our designees at any time for the amount of the outstanding loans. All voting rights of the VIEs are then assigned to us. We have the power to appoint all directors and senior management personnel of the VIEs. Through our wholly owned subsidiaries in China, we have also entered into exclusive technical agreements and other service agreements with the VIEs, under which these subsidiaries provide technical services.

BUSINESS COMBINATIONS

The Company accounts for its business combinations using the purchase method of accounting. This method requires that the acquisition cost to be allocated to the assets and liabilities the Company acquired based on their fair values. The Company makes estimates and judgments in determining the fair value of the acquired assets and liabilities, based on valuations using management's estimates and assumptions including its experience with similar assets and liabilities in similar industries. If different judgments or assumptions were used, the amounts assigned to the individual acquired assets or liabilities could be materially different.

GOODWILL AND PURCHASED INTANGIBLE ASSETS

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Company's acquisitions of interests in its subsidiaries and VIEs. Under Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets ("SFAS 142")," goodwill is no longer amortized, but tested for impairment upon first adoption and annually, thereafter, or more frequently if events or changes in circumstances indicate that it might be impaired. The Company assesses goodwill for impairment periodically in accordance with SFAS 142.

The Company applies the criteria specified in SFAS No. 141, "Business Combinations" to determine whether an intangible asset should be recognized separately from goodwill. Intangible assets acquired through business acquisitions are recognized as assets separate from goodwill if they satisfy either the "contractual-legal" or "separability" criterion. Per SFAS 142, intangible assets with definite lives are amortized over their estimated useful life and reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets." Intangible assets, such as purchased technology, trademark, customer list, user base and non-compete agreements, arising from the acquisitions of subsidiaries and variable interest entities are recognized and measured at fair value upon acquisition. Intangible assets are amortized over their estimated useful lives from one to ten years. The Company reviews the amortization methods and estimated useful lives of intangible assets at least annually or when events or changes in circumstances indicate that it might be impaired. The recoverability of an intangible asset to be held and used is evaluated by comparing the carrying amount of the intangible asset to its future net undiscounted cash flows. If the intangible asset is considered to be impaired, the impairment loss is measured as the amount by which the carrying amount of the intangible asset exceeds the fair value of the intangible asset, calculated using a discounted future cash flow analysis. The Company uses estimates and judgments in its impairment tests, and if different estimates or judgments had been utilized, the timing or the amount of the impairment charges could be
different.

We currently have seven reporting units: Lion Zone, Linkhead, EPRO, Smartime/Soluteck, Clickcom-WOFE, and Guangzhou 3G-WOFE for the purpose of goodwill assessment. We determined our reporting units if the entity constituted a business, financial information was available, and segment management can regularly review the operating results of that component. Excluding investment holding vehicles and self-developed units, reporting units only include those operating units that PacificNet holds 51% or more through acquisition and maintain effective control. Units such as PacificNet Solution, PacificNet Limited, and PacificNet Communication are 100% owned by PacificNet through self development and not through acquisition. Therefore, there is no goodwill allocation to these self-developed units.

We allocated goodwill amongst the reporting units based on the consideration paid in shares and cash minus the proportional share of the fair value of net assets and liabilities at the time of acquisition specific to each reporting unit. The fair value of each reporting unit represents the amount at which the unit as a whole could be bought or sold in a current transaction between willing parties in an open marketplace. At the time of acquisition, the fair value of assets and liabilities was determined based on book value minus any potential write-down, if any, to reflect the fair value of the assets and liabilities acquired in the transaction.

The Company has one class of goodwill arising from business combination resulting from the acquisitions of our subsidiaries. Goodwill has been revised to reflect certain expenses that should have been written off prior to certain acquisitions, not subsequent to the acquisitions, to better reflect the assets acquired and liabilities assumed in certain business combinations during 2003 in accordance with SFAS No. 141, "Business Combinations”.

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 goodwill on the restated balance sheet
Balance as of December 31, 2003	$ 420	$ -	$ -	$ 420
Goodwill acquired during the year	3,575	4,831	1,438	9,844
Goodwill impaired during the year	(31)	(1,159)	(1,438)	(2,628)
Balance as of December 31, 2004-Restated	3,964	3,672	-	7,636
Goodwill acquired during the year	-	5,183	-	5,183
Goodwill impaired during the year	-	(3,689)	-	(3,689)
Balance as of December 31, 2005-Restated	$ 3,964	$ 5,165	$ -	$ 9,129

The Company assesses the need to record impairment losses on our goodwill assets at least annually or when an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The assessment includes using a combination of qualitative and quantitative analyses such as DCF/PE multiples based on 5 year profit forecasts, and published comparables, where applicable. The Company concluded that there have been no material adverse changes on the operating environments during the reporting periods that would have otherwise affected the carrying value of the goodwill. In addition, there has been no disposal of any reporting subsidiaries and, as a result, no gain or loss is recognized during those reporting periods

The following table summarizes goodwill from the Company's acquisitions during 2005 and 2004:

(US$'000s)	Year December 31, 2005 **Restated**	2004 **Restated**
Epro	$ 3,949	$ 3,949
Linkhead	249	3,672
Smartime (Soluteck)	15	15
Clickom	268	-
GZ3G(Sunroom)	3,900	-
Lion Zone(ChinaGoHi)	748	-
Total	$ 9,129	$ 7,636

IMPAIRMENT OF LONG-LIVED ASSETS

The Company periodically assesses the need to record impairment losses on long-lived assets, such as property, plant and equipment, and purchased intangible assets, used in operations and its investments when indicators of impairment are present indicating the carrying value may not be recoverable. 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. When impairment is identified, the carrying amount of the asset is reduced to its estimated fair value. All goodwill will no longer be amortized and potential impairment of goodwill and purchased intangible assets with indefinite useful lives will be evaluated using the specific guidance provided by SFAS No. 142 and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

This impairment analysis is performed at least annually. For investments in affiliated companies that are not majority-owned or controlled, indicators or value generally include revenue growth, operating results, cash flows and other measures. Management then determines whether there has been a permanent impairment of value based upon events and circumstances that have occurred since acquisition. It is reasonably possible that the impairment factors evaluated by management will change in subsequent periods, given that the Company operates in a volatile environment. This could result in material impairment charges in future periods.

INVESTMENTS IN AFFILIATED COMPANIES

The Company's investments in affiliated companies for which its ownership exceeds 20%, but is not majority-owned or controlled, are accounted for using the equity method. The Company's investments in affiliated companies for which its ownership is less than 20% are accounted for using the cost method.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) consists of net earnings and other gains (losses) affecting stockholders' equity that, under generally accepted accounting principles are excluded from net earnings in accordance with Statement of Financial Accounting Standards ("SFAS") 130, Reporting Comprehensive Income.

REVENUE RECOGNITION

Revenues are derived from the following categories as classified by our operating segments (see Note 15): (1) outsourcing services including Business Process Outsourcing (BPO), call center, IT Outsourcing (ITO) and software development services; (2) Value-Added Telecom Services (VAS) including Content Providing (CP), Interactive Voice Response (IVR), Platform Providing (PP) and Service Providing (SP); and (3) Communication Products Distribution Services, including calling cards, GSM/ CDMA/ XiaoLingTong products, and multimedia self-service kiosks.

Revenues from outsourcing services are recognized when the services are rendered. Revenues from license agreements are recognized when a signed non-cancelable software license exists, delivery has occurred, the Company's fee is fixed or determinable, and collectibility is probable at the date of sale. Revenues from software development services are recognized when the customer accepts the installation and no significant modification or customization work is involved, in accordance with SOP 97-2 "Software Revenue Recognition." Revenues from support services such as consulting, implementation and training services are recognized when the services are performed, collectibility is probable and such revenues are contractually nonrefundable.

Revenues from value-added telecom services are derived principally from providing mobile phone users with short messaging service ("SMS"), multimedia messaging service ("MMS"), color ring back tone ("CRBT"), wireless application protocol ("WAP") and interactive voice response system ("IVR"). These services include news and other

content subscriptions, mobile dating service, picture and logo download, ring tones, ring back tones, mobile games, chat rooms and access to music files. These revenues from are charged on a monthly or per-usage basis and are recognized in the period in which the service is performed, provided that no significant Company obligations remain, collection of the receivables is reasonably assured and the amounts can be accurately estimated. In accordance with EITF No. 99-19, "Reporting Revenues Gross as a Principal Versus Net as an Agent," revenues are recorded on a gross basis when the Company is considered the primary obligor to the VAS users. Under the gross method, the amounts billed to VAS users are recognized as revenues and the fees charged or retained by the third-party operators are recognized as cost of revenues.

Revenues from the sale of products and systems are recognized when the product and system is completed, shipped, and the risks and rewards of ownership have transferred.

Revenues from the distribution of all types of calling cards and product sales is recognized in accordance with EITF No. 99-19, "Reporting Revenues Gross as a Principal Versus Net as an Agent," where revenues are recorded on a gross basis when the Company is considered the primary obligor to the users, maintains an inventory of products before the products are ordered by customers, has latitude in establishing the pricing power of products, is subject to physical inventory loss risk, and has credit risk as it is responsible for collecting the sales price from the customer and is responsible for paying the supplier regardless of whether or not the sales price is fully collectible.

The effect of post-shipment/delivery obligations, such as customer acceptance, product returns, etc. on our revenue recognition policy is as follows: (a) there is no effect on outsourcing services as revenue is recognized as the services are performed; however product sale revenue is recognized when contracts are approximately 80% completed for revenue recognition and fully when the customer signs the UAF, (i.e., "User Acceptance Form"); (b) there is no effect on value-added services revenue as the product sales mainly involve IVR hardware that are from mature and stable products of multi-national vendors and there have been minimal returns historically; and (c) there is no effect on communication products distribution since the transactions are conducted on cash basis and revenue is recognized at the time the sale is transacted.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company presents accounts receivable, net of allowances for doubtful accounts and returns. The allowances are calculated based on a detailed review of certain individual customer accounts, historical rates and an estimate of the overall economic conditions affecting the Company's customer base. The Company frequently monitors its customers' financial condition and credit worthiness and only sells products, licenses or services to customers where, at the time of the sale, collection is reasonably assured. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company also records 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, the Company's estimates of the recoverability of receivables could be further adjusted. Allowance for doubtful accounts for the years ended December 31, 2005 and 2004 amounted to $168,000 and $559,000 respectively.

PROPERTY AND EQUIPMENT

Property and equipment is stated at cost and depreciated using the straight-line method over the shorter of the estimated useful life of the asset or the lease term, ranging from three to five years. Significant improvements and betterments are capitalized. Routine repairs and maintenance are expensed when incurred. When property and equipment is sold or otherwise disposed of, the asset account and related accumulated depreciation account are relieved, and any gain or loss is included in operations.

INVENTORIES

Inventories consist of finished goods and are stated at the lower of cost or market value. Cost is computed using the first-in, first-out method and includes all costs of purchase and other costs incurred in bringing the inventories to their present location and condition. Market value is determined by reference to the sales proceeds of items sold in the ordinary course of business after the balance sheet date or management estimates based on prevailing market conditions. The inventories consist of finished goods and represent telecommunication products such as mobile phone, rechargeable phone cards, smart chip, and interactive voice response cards.

INCOME TAXES

Income taxes are accounted for using an asset and liability approach, which requires the recognition of income taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Company's consolidated financial statements or tax returns. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax laws; the effects of future changes in tax laws or rates are not anticipated. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence assessed using the criteria in SFAS No. 109, "Accounting for Income Taxes," will not more-likely-than-not be realized.

The Company records a valuation allowance for deferred tax assets, if any, based on estimates of its future taxable income as well as its tax planning strategies when it is more likely than not that a portion or all of its deferred tax assets will not be realized. If the Company is able to utilize more of its deferred tax assets than the net amount previously recorded when unanticipated events occur, an adjustment to deferred tax assets would be reflected in income when those events occur.

For the year ended December 31, 2005, income taxes of $43,000, $217,000 and $0 and $12,000 was incurred from the Company's four business units: (1) CRM Outsourcing Services, (2) Value Added Services (VAS), (3) Telecom

Distribution Services and (4) Other Business.

For the year ended December 31, 2004, income taxes of $70,636, $25,913 and $9,665 from Smartime, Perpetual growth and Epro respectively.

RESEARCH AND DEVELOPMENT COSTS AND CAPITALIZED SOFTWARE COSTS

Expenditures related to the research and development of new products and processes, including significant improvements and refinements to existing products are expensed as incurred, unless they are required to be capitalized.

Software development costs are required to be capitalized when a product's technological feasibility has been established by completion of a detailed program design or working model of the product, and ending when a product is available for release to customers. For the years ended December 31, 2005 and 2004, the Company did not capitalize any costs related to the purchase of software and related technologies and content. There was no research and development costs charged to operations for the year ended December 31, 2005 and 2004.

EARNINGS PER SHARE (EPS)

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 and 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. Weighted average number of shares used to calculate basic and diluted loss per share is considered same as the effect of dilutive shares is anti-dilutive.

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

(In thousands of US Dollars, except weighted shares and per share amounts.)	**Year December 31, 2005 Restated**	**2004 Restated**
Numerator: Net loss	$ (5,145)	$ (5,425)
Denominator:		
Weighted-average shares used to compute basic & diluted loss per share	10,156,809	7,015,907
Basic & diluted loss per common share:	$ (0.51)	$ (0.78)

STOCK-BASED COMPENSATION PLANS

The Company has adopted SFAS No. 123, "Accounting for Stock Based Compensation". As permitted by SFAS No. 123, the Company measures compensation cost in accordance with Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Compensation cost for stock options, if any, is measured as the excess of the quoted market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. Accordingly, no accounting recognition is given to stock option granted at fair market value until they are exercised. Upon exercise, net proceeds including tax benefits realized, are credited to equity. Details regarding a description and status of the Company's stock option plans can be found in Note 12.

The Company's net earnings (loss) and net earnings (loss) per common share would have changed to the pro forma amounts indicated below if compensation cost for the Company's stock option had been determined based on fair value at the grant date for awards in accordance with SFAS No. 123, (in thousands, except per share amounts):

	FY 2005	FY 2004
Net earnings/ (loss):		
As reported	$ (5,145)	$ (5,425)
Stock-based compensation cost APB 25	282	1,246
Stock-based compensation cost FAS 123R	(364)	(1,905)
Pro forma	$ (5,227)	$ (6,084)
Basic & diluted loss per share:		
As reported	$ (0.51)	$ (0.78)
Pro forma	$ (0.51)	$ (0.87)

The fair value of options granted during 2005 and 2004, respectively was approximately $1.41 and $1.78 per option respectively based on the Black-Scholes option pricing model using valuation assumptions of: a) average remaining contractual life of two years and three years; b) expected volatility of 148% and 61.33%, c) dividend yield of 0% for both years; and d) a risk free interest rate of 2.75% and 2.75%.

ADVERTISING EXPENSES

Advertising expenses consist primarily of costs of promotion for corporate image and product marketing and costs of direct advertising. The Company expenses all advertising costs as incurred and classify these costs under selling, general and administrative expenses, which amounted to$129,000 in 2005 (2004: $55,000).

CASH EQUIVALENTS

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Bank overdrafts that are repayable on demand and form an integral part of the PacificNet's cash management are also included as a component of cash and cash equivalents for the purpose of the cash flow statement. Highly liquid investments with original maturities of three months or less are considered cash equivalents.

RELATED PARTY TRANSACTIONS

A related party is generally defined as (i) any person that holds 10% or more of the Company's securities including such person's immediate families, (ii) the Company's management, (iii) someone that directly or indirectly controls, is controlled by or is under common control with the Company, or (iv) anyone who can significantly influence the financial and operating decisions of the Company. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties. (See Note 12)

RECLASSIFICATION

Certain prior period amounts have been reclassified to conform to the current year presentation. These changes had no effect on previously reported results of operations or total stockholders' equity.

FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is described as the amount at which the instrument could be exchanged in a current transaction between informed willing parties, other than a forced liquidation. Cash and cash equivalents, accounts receivable and payable, accrued expenses and other current liabilities are reported on the consolidated balance sheets at carrying value which approximates fair value due to the short-term maturities of these instruments. The Company does not have any off balance sheet financial instruments.

CONCENTRATION OF CREDIT RISK

CASH HELD IN BANKS: For those financial institutions that the Company maintains cash balances in the United States, the amounts are insured by the Federal Deposit Insurance Corporation up to $2,182,000.

GEOGRAPHIC RISK: All of the Company's revenues are derived in Asia and Greater China and its operations are governed by Chinese laws and regulations. The operations in China are carried out by the subsidiaries and VIEs. If the Company was unable to derive any revenue from Asia and Greater China, it would have a significant, financially disruptive effect on the normal operations of the Company.

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

MARKETABLE EQUITY SECURITIES

Marketable equity securities are classified as available-for-sale and are recorded at fair value in other assets on the balance sheet, with the change in fair value during the period excluded from earnings and recorded net of tax as a component of other comprehensive income. Realized gains or losses are charged to the income statement during the period in which the gain or loss is realized. Investments classified as available-for-sale securities include marketable equity securities of Unit Trust Funds and are based primarily on quoted market prices at December 31, 2005. The component costs of these securities are summarized as follows: cost of $586,000, gross unrealized losses of $47,000 and estimated fair value of $539,000 as at December 31, 2005 and cost of $46,000, gross unrealized losses of $17,000 and estimated fair value of $29,000 as at December 31, 2004. The acquisition of marketable securities and unrealized losses on marketable equity securities are recorded on consolidated statements of cash flows.

FOREIGN CURRENCY

The Company's reporting currency is the U.S. dollar. The Company's operations in China and Hong Kong use their respective currencies as their functional currencies. The financial statements of these subsidiaries are translated into U.S. dollars using period-end rates of exchange for assets and liabilities and average rates of exchange in the period for revenue and expenses. Translation gains and losses are recorded in accumulated other comprehensive income or loss as a component of shareholders' equity. Net gains resulting from foreign exchange transactions are included in General and Administrative Expenses an amount to $27,000 and $(22,000) for the years ended December 31, 2005 and 2004.

SEGMENT INFORMATION

The Company determines and classified its operating segments in accordance with SFAS No. 131 "DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION" based on the following considerations: (a) each of the Company's operating segments is a discrete business unit that earns revenues and incurs expenses; (b) the operating results are regularly reviewed by PacificNet's chief operating decision makers for the purposes of fine-tuning its strategies going forward, making resource allocation decisions such as whether further working capital advances are required and assessing individual performance; and (c) discrete financial information for each subsidiary within each operating segment is available. The chief operating decision makers are the Company's President and CEO and its Chairman, and their decisions are based on discussions with each segment's senior management and financial controllers regarding non-financial indicators such as customer satisfaction, loyalty and new marketplace competition as well as financial indicators such as internally generated financial statements, to assess overall financial performance.

GOING CONCERN

As shown in the accompanying consolidated financial statements, the Company incurred accumulated losses of $38.6 million and $33.5 million as of December 31, 2005 and 2004, respectively. Net loss for the years ended December 31, 2005 and 2004 is $5.15 million and $5.43 million respectively. In addition, the Company is in default on its convertible debenture obligation (See note 15). 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 Restated 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 not limited to: 1) accelerate disposal and spin-off of unprofitable or unfavorable return-on-investment non-gaming operations. 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. On May 5, 2007, the Company also entered into a sale and purchase agreement to dispose of the real estate in HK for approximately US$1 million; 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; 5) issuance and/or restructure of new long-term convertible debentures.

RECENT PRONOUNCEMENTS

The Financial Accounting Standards Board issued the following recent accounting pronouncements:

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 under funded 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 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.

In July 2006, the FASB released FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48) FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. This interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. This statement is effective for fiscal years beginning after December 15, 2006. The management is currently evaluating the effect of the adoption of FIN 48.

In March 2006 FASB issued SFAS 156 “Accounting for Servicing of Financial Assets.” This Statement amends FASB Statement No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Company does not have any servicing assets and therefore the statement will not have any impact on the financial statements.

In February 2006, FASB issued SFAS No. 155, “Accounting for Certain Hybrid Financial Instruments.” SFAS No. 155 amends SFAS No 133, “Accounting for Derivative Instruments and Hedging Activities,” and SFAF No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.” SFAS No. 155, permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interest in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends SFAS No. 140 to eliminate the prohibition on the qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. The management is currently evaluating the effect of this pronouncement on financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections". SFAS No. 154 replaces APB Opinion No. 20 "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The adoption of SFAS No. 154 did not impact the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS Statement No. 153, "Exchanges of Nonmonetary Assets." The Statement is an amendment of APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive

assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. The Company believes that the adoption of this standard will have no material impact on its financial statements.

In December 2004, the FASB issued SFAS No. 123R (revised 2004) "Share-Based Payment" which amends FASB Statement No. 123 and will be effective for public companies (small business issuers) for interim or annual periods beginning after December 15, 2005. SFAS 123R requires that compensation cost related to share-based payment transactions be recognized in the financial statements. Share-based payment transactions within the scope of SFAS 123R include stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee share purchase plans. The Company adopted the new standard as of January 1, 2006. Based on the Company's evaluation of the adoption of the new standard, the Company believes that it could have a significant impact to the Company's financial position and overall results of operations depending on the number of stock options granted in a given year.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments." The EITF reached a consensus about the criteria that should be used to determine when an investment is considered impaired, whether that impairment is other-than-temporary, and the measurement of an impairment loss and how that criteria should be applied to investments accounted for under SFAS No. 115, "ACCOUNTING IN CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES." EITF 03-01 also included accounting considerations subsequent to the recognition of other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. Additionally, EITF 03-01 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the Financial Accounting Standards Board (FASB) delayed the accounting provisions of EITF 03-01; however the disclosure

2. BUSINESS ACQUISITIONS

During 2005 and 2004, PacificNet acquired various entities in accordance with the Company's strategy to grow via mergers and acquisitions. The entities acquired met various PacificNet acquisition criteria, which include reasonable expectations for positive earnings and cash flow within two years of acquisition and reputation for high quality and performance in the customer relationship management, brand name recognition, and well-established relationships with clients. Several factors contributed to the determination of the negotiated purchase price and deal structure. Among them were the value of assets acquired and liabilities assumed, historical EBITDA and projected EBITDA. The assets acquired and liabilities assumed were recorded at estimated fair values as determined by the Company's management based on information currently available and on current assumptions as to future operations

A summary of business acquisitions for the periods presented follows:

SHANGHAI CLASSIC GROUP LIMITED ("YUESHEN")

On April 12, 2004, the Company, through its subsidiary PacificNet Strategic Investment Holdings Limited, consummated the acquisition of a 100% controlling interest (the "Acquisition") in Shanghai Classic Group Limited, which owns 51% of Guangzhou YueShen TaiYang Technology Limited, a newly formed telecommunication company located and incorporated in the People's Republic of China ("Yueshen"). The Company acquired the 100% controlling interest in Shanghai Classic through the purchase of 85 shares (representing 100% of the issued and outstanding shares, the "Shanghai Shares") of Shanghai Classic Group Limited, which is also the beneficial owner of the 51% controlling interest in Yueshen. The consideration for the Acquisition was an aggregate value of approximately USD$1,679,532, which was paid in cash and shares of common stock of the Company (the "Common Stock"), and a warrant to purchase up to 50,000 shares of Common Stock. The consideration was paid as follows:

(i) 106,240 shares of Common Stock as consideration for the purchase of 51% of the Shanghai Shares from Yan Kuan Li ("Ms. Li") within thirty (30) days of the signing of the agreement for the Acquisition. All of the Common Stock deliverable to Ms. Li is being held in escrow pursuant to the terms of an escrow agreement, which provides that the Common Stock will be released in installments over the twelve month period following the consummation of the Acquisition, provided, that Yueshen attains certain net income milestones during such period. In the event there is a shortfall in the net income during the period Ms. Li shall return to the Company shares of Common Stock equivalent to the dollar amount of such shortfall divided by $5.80; and

(ii) approximately USD$338,303 in cash as consideration for the purchase of 34 of the Shanghai Shares from Avatar Trading, Ltd. ("Avatar") within thirty (30) days of the closing of the Acquisition; and

(iii) approximately USD$241,645 in cash directly to Yueshen within thirty (30) days of the closing of the Acquisition, as consideration for the purchase of the Yueshen shares by Shanghai Classic.

(iv) A common stock purchase warrant to purchase 50,000 shares of PacificNet common stock, par value $0.0001 per share. The exercise price under this warrant shall be the 5-Day volume weighted average price of the common stock of PacificNet before the signing date of this Agreement, exercisable within 3 years from the date of issuance. The warrants are considered contingent consideration and have not been valued as the contingency has not been met. (See Note 5)

The cash portion of the purchase price for the Acquisition was paid from working capital of the Company. The value of the common shares issued was determined based on the average market price of PacificNet's common shares over a reasonable period before and after the terms of the acquisition were agreed to and announced.

The company accounted for the acquisition using the equity method of accounting due to the following reasons.

The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. However, there are exceptions to this general rule. FAS 94, that amended ARB No. 51, Consolidated Financial Statements, stipulates that a majority-owned subsidiary shall not be consolidated if control is likely to be temporary or if it does not rest with the majority owner.

It follows that Yueshen has been excluded from consolidation to the Company's consolidated financial statements for the years ended December 31, 2004 and 2005 on the grounds that the control of Yueshen was temporary for two main reasons. First, the Company had never been given full access to detailed financial information of Yueshen by its legal representative. .Second, since the legal representative of Yueshen refused to cooperate, the Company, despite of its 51% ownership, never managed to obtain board control through nominating new directors to the board of Yueshen.

Accordingly, operating results of Yueshen have been accounted for using equity method for the years ended December 31, 2004 and 2005.

Following is the summary of investment as of December 31, 2005 and 2004.

(In thousands of U.S Dollars)	2005		2004
Initial investment	n/a	$	1,680
Net income	n/a		(242)
Total	n/a		1,438
Impairment of investment	n/a		(1,438)
Net	n/a	$	-

As of December 31, 2004 the Company impaired $1,438,909 in investment as the recoverability of the investment is uncertain due to the litigation between the Company and Yueshen (See note 15).

PACIFIC SMARTIME SOLUTIONS LIMITED ("SMARTIME")

On September 15, 2004, the Company, through its subsidiary PacificNet Strategic Investment Holdings Limited, consummated the acquisition of a 51% controlling interest (the "Acquisition") in Soluteck Technology (Shenzhen) Company Limited, a corporation incorporated in Shenzhen, China ("Soluteck"). The Company acquired the controlling interest in Soluteck through the purchase of 630 shares (the "Shares") or 63% ownership interest of Pacific Smartime Solutions Limited ("Smartime"), the beneficial owner of an 81% controlling interest in Soluteck, from the shareholders of Smartime. The consideration for the Acquisition was payable as follows:

(i) 100,000 shares of common stock of the Company (the "Common Stock"), deliverable within 30 days of signing the Agreement. All of the Shares deliverable to the Shareholders are being held in escrow pursuant to the terms of an escrow agreement, which provides that the Common Stock will be released in installments over the twelve month period ending on September 30, 2005; provided that Soluteck meets certain net income milestones during such period. If at the end of the second twelve month period ending on September 30, 2006, there is a shortfall in Soluteck's net income, the Shareholders shall return to the Company Shares equivalent to the dollar amount of such shortfall divided by $5.00; and

(ii) warrants to purchase up to 50,000 shares of common stock at an exercise price equal to the 5 day volume weighted average price of the Company's common stock before the signing of the Agreement. The warrants are exercisable for a period of 3 years from the date of issuance. The warrants are considered contingent consideration and have not been

valued as the contingency has not been met. (See Note 5).

In connection with the Acquisition, the Company's subsidiary has agreed to provide Soluteck with an operating loan of RMB 3,000,000; provided that Soluteck secures certain contracts with Huawei. The loan would mature within 3 years with interest at a rate of 4% per year.

F-18

A summary of the assets acquired and liabilities assumed in the acquisition follows (In thousands of US Dollars):

Estimated fair values:	**Restated**
Current Assets	$ 460,957
Property Plan and equipment	61,067
Current Liabilities assumed	(255,024)
Net asset acquired	267,000
Consideration paid:	
Shares	282,000
Goodwill	$ $15,000

The Company recorded the shares at the fair market value at the date of consummation and recorded goodwill of $15,000.

In accordance with SFAS 142, goodwill is not amortized but is tested for impairment at least annually. There is no change in the value of goodwill as of December 31, 2005 and 2004.

The purchase price allocation for Smartime 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 Smartime. Accordingly, the operating results of Smartime have been consolidated with those of the Company starting September 15, 2004.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE YEAR ENDED DECEMBER 31, 2005 AND 2004

The following unaudited pro forma consolidated financial information for the years ended December 31, 2004 and 2005, as presented below, reflects the results of operations of the Company assuming the acquisition occurred on January 1, 2004 and 2005 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, 2004 and 2005 respectively, and may not be indicative of future operating results.

Smartime	**Year ended December 31**	
	2005	**2004**
	Restated	**Restated**
(In thousands of U.S Dollars except for earnings per share)	**(Unaudited)**	**(Unaudited)**
Revenues	$ 31,086	$ 18,623
Operating Loss	(4,333)	(4,588)
Net loss attributable to shareholders	(5,145)	(5,549)
Loss per share-basic & diluted	$ (0.51)	$ (0.79)

PacificNet included the financial results of Smartime in its consolidated 2005 financial results and from the date of the purchase, September 15, 2004 through December 31, 2004.

PACIFICNET CLICKOM LIMITED

On December 16, 2004, we entered into an agreement to acquire a controlling interest in Guangzhou Clickcom Digit-net Science and Technology Ltd. ("Clickcom-WOFE") through the purchase of a 51% interest of

Clickcom-WOFE's parent company, PacificNet Clickcom Limited, a British Virgin Islands Company ("Clickcom-BVI") from three shareholders, Mr. Jinnan Lai, Mr. Ming Zhang and Mr. Dong Liu who are majority shareholders of GuangZhou DianXun Company Limited ("Dianxun-DE"), a PRC registered Domestic Enterprise (DE) either. The acquisition was completed on March 28, 2005 upon receipt of the required business license and approval from the local government.

The total purchase consideration for 51% of Clickcom is payable 30% in cash and 70% in restricted shares of PACT. The purchase price is payable upon achievement of certain quarterly earn-out targets based on net profits, through the issuance of 130,000 restricted shares of common stock of PacificNet. As of December 31, 2005, cash consideration of $268,000 and stock consideration of $402,480, representing 52,000 restricted shares of PACT common stock valued at$7.65 per share for 26,000 shares issued at the time of completion of acquisition and at $7.83 per share for 26,000 shares issued on achievement of net earnings target, were recorded as the cost of acquisition. Total unearned purchase consideration in the form of common stock to be distributed based on the achievement of earnings was 78,000 restricted shares (See Note 12). PacificNet will also issue warrants to purchase 50,000 shares of PacificNet's common stock. The warrants are considered contingent consideration and have not been valued as the contingency has not been met. (See Note 5).

The cash portion of the purchase price for the Acquisition was paid from working capital of the Company. The value of the common shares issued was determined based on the average market price of PacificNet's common shares over a reasonable period before and after the terms of the acquisition were agreed to and announced.

A summary of the assets acquired and liabilities assumed at the time of acquisition as follows (In thousands of US Dollars):

Estimated fair values:	**Restated**
Current Assets	$ 136,474
Net asset acquired	136,474
Consideration paid:	
Shares	198,900
Cash paid	268,004
Goodwill	$ 330,430

The Company recorded goodwill of $267,786 and 330,430 as at December 31, 2005 and 2004 respectively.

In accordance with SFAS 142, goodwill is not amortized but is tested for impairment at least annually. As at December 31, 2005 the Company impaired goodwill by $266,096.

Following is the summary of goodwill as at December 31, 2005 and 2004.

	Goodwill
As at 12-31-04	$ 330,430
Additional issuance of shares during 2005	203,452
Impairment	(266,096)
As at 12-31-05	$ 267,786

The purchase price allocation for the Clickcom acquisition was based on a management's estimates and overall industry experience. Immediately after the signing of the definitive agreement, the Company obtained effective control over Clickcom. Accordingly, the operating results of Clickcom have been consolidated with those of the Company starting March 28, 2005. 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$600,000 for 12 months ended December 31, 2005 is available. Accordingly, the contingent consideration of 78,000 restricted shares has not been reflected in the consolidated financial statements of the Company as of December 31, 2005 due to the performance target not being met.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE YEAR ENDED DECEMBER 31, 2005 AND 2004

The following unaudited pro forma consolidated financial information for the years ended December 31, 2004 and 2005, as presented below, reflects the results of operations of the Company assuming the acquisition occurred on January 1, 2004 and 2005 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, 2004 and 2005 respectively, and may not be indicative of future operating results.

Clickcom	**Year ended December 31**	
(In thousands of U.S Dollars)	**2005**	**2004**
	Restated	**Restated**

	(Unaudited)	(Unaudited)
Revenues	$ 31,086	$ 16,942
Operating income	(4,333)	(4,588)
Net profit	(5,145)	(5,425)
Loss per share-basic & diluted	$ (0.51)	$ (0.77)

PacificNet included the financial results of Clickcom in its consolidated 2005 financial results from the date of the purchase, March 28, 2005 through December 31, 2005.

GUANGZHOU 3G INFORMATION TECHNOLOGY CO. LTD

On March 30, 2005 we entered into an agreement to acquire a controlling interest in Guangzhou 3G Information Technology Co. Ltd. ("Guangzhou3G-WOFE"), a PRC registered wholly owned foreign enterprise (WOFE), through the purchase of a 51% interest of Guangzhou 3G's parent company, Pacific 3G Information & Technology Co. Limited, a British Virgin Islands Company ("Guangzhou3G-BVI") from three shareholders, ASIAFAME INTERNATIONAL LIMITED, STARGAIN INTERNATIONAL LIMITED, and TRILOGIC INVESTMENTS LIMITED. All of above three shareholders are incorporated in BVI. Guangzhou3G-WOFE conducts it VAS operations with Guangzhou Sunroom Information Industrial Co., Ltd. ("Sunroom-DE"), a PRC registered Domestic Enterprise (DE), through a series of contractual agreements.

The details of the acquisition are as follows:

The purchase price for 51% controlling interest which is payable 29% in cash and 71% in restricted shares of PacificNet. The purchase price includes $500,000 cash payable to Guangzhou 3G, and the remaining amount payable to the selling shareholders through the issuance of restricted shares of common stock of PacificNet plus $1.18 million cash payable to the sellers upon achievement by Guangzhou 3G of certain quarterly earn-out targets based on net profits. As of December 31, 2005, cash consideration of $1,683,000 and stock consideration of $2,470,453, representing 326,400 restricted shares of PACT common stock valued at $7.65 per share for 130,050 shares, $7.83 per share for 98,175 shares and $7.20 per share for 98,175 shares were recorded as the cost of the acquisition. Total unearned purchase consideration in the form of common stock to be distributed based on the achievement of earnings was 196,350 restricted shares (See Note 12). PacificNet also issue warrants to purchase 100,000 shares of PacificNet's common stock. The warrants have never been issued since it is contingent upon a certain earning milestone which has not been met (See Note 5).

The cash portion of the purchase consideration was paid from working capital of the Company. The value of the common shares issued was determined based on the average market price of PacificNet's common shares over a reasonable period before and after the terms of the acquisition were agreed to and announced.

A summary of the assets acquired and liabilities for Guangzhou 3G WOFE assumed in the acquisition follows (In thousands of US Dollars):

Estimated fair values:	**Restated**
Current Assets	$ 253,000
Net asset acquired	253,000
Consideration paid:	
Shares	2,470,453
Cash paid	1,683,000
Goodwill	$ 3,900,453

The Company recorded goodwill of $3,900,453 as at December 31, 2005.

In accordance with SFAS 142, goodwill is not amortized but is tested for impairment at least annually. The purchase price allocation for Guangzhou3G 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 Guangzhou3G. Accordingly, the operating results of Guangzhou 3G have been consolidated with those of the Company starting March 30, 2005. 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$2,000,000 for the 12 months ended December 31, 2005 is available. Accordingly, the contingent consideration of 196,350 shares has not been reflected in the consolidated financial statements of the Company as of December 31, 2005.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE YEAR ENDED DECEMBER 31, 2005 AND 2004

The following unaudited pro forma consolidated financial information for the years ended December 31, 2004 and 2005, as presented below, reflects the results of operations of the Company assuming the acquisition occurred on January 1, 2004 and 2005 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, 2004 and 2005 respectively, and may not be indicative of future operating results.

GZ 3G	**Year ended December 31**	
	2005	**2004**
	Restated	**Restated**
(In thousands of U.S Dollars)	**(Unaudited)**	**(Unaudited)**
Revenues	$ 46,509	$ n/a
Operating income	1,851	n/a
Net profit	1,136	n/a
Earnings per share-basic&diluted	$ 0.11	$ n/a

PacificNet included the financial results of 3G in its consolidated 2005 financial results from the date of the purchase, March 30, 2005 through December 31, 2005.

SHENZHEN GUHAIGUANCHAO INVESTMENT CONSULTANT COMPANY LIMITED ("CHINAGOHI")

On December 19, 2005, we closed an agreement to purchase a 51% interest in Shenzhen GuHaiGuanChao Investment Consultant Company Limited ("ChinaGoHi"), a wholly owned foreign enterprise (WOFE) registered in China and a provider of DRTV infomercial marketing company for financial advisory services in China. On October 3, 2005 we announced that we had signed an agreement dated as of September 30, 2005 to acquire 51% of the outstanding shares of ChinaGoHi from Hitching International Corporation ("HIC"), the former majority owner of ChinaGoHi to be closed upon the completion of due diligence and the approval of the WOFE structure by China's Industry and Commerce Department.

As a result of the due diligence process and receipt of the Chinese government's WOFE approval, we and HIC agreed to amend the Sale and Purchase Agreement and entered into a Supplementary Agreement dated as of December 1, 2005 (the "Supplementary Sale and Purchase Agreement") and permitted us to have direct ownership of ChinaGoHi through the acquisition of 51% of the outstanding shares from Lion Zone Holdings Limited instead of HIC.

We agreed to purchase 12,850 existing ordinary shares (the "Sale Shares") of ChinaGoHi from Lion Zone Holdings Limited (the "Seller") and to subscribe 5,000 newly issued ordinary shares (the "Subscription Shares") from the Seller, which together with the Sale Shares, being 17,850 or 51% of the 35,000 entire outstanding shares of ChinaGoHi. The purchase price for 51% of the outstanding shares of ChinaGoHi was payable as follows: US$2.1 million payable in cash to the Seller and 825,000 shares of our common stock valued. The purchase price is payable upon achievement of certain quarterly earn-out targets based on net profits, through the issuance of our 825,000 shares. As at December 31, 2005 the Company paid $775,000 for seller shares and $1,500,000 for subscription shares and issued 137,500 shares valued at $7.03 per share at the date of consummation of agreement.

The cash portion of the acquisition consideration was for the working capital of the Company. The value of the common shares issued was determined based on the average market price of PacificNet's common shares over a reasonable period before and after the terms of the acquisition were agreed to and announced.

A summary of the assets acquired and liabilities assumed in the acquisition follows (In thousands of US Dollars):

Estimated fair values:	**Restated**
Current Assets	$ 4,785,924
Property Plan and equipment	157,376
Current Liabilities assumed	(2,449,981)
Net asset acquired	2,493,319
Consideration paid:	
Shares	966,625
Cash paid	2,275,000
Goodwill	$ 748,306

The Company recorded goodwill of $748,306 as at December 31, 2005.

In accordance with SFAS 142, goodwill is not amortized but is tested for impairment at least annually. The purchase price allocation for ChinaGohi acquisition is based on management's estimates and overall industry experience. Immediately after the signing of the definitive agreement, the Company obtained effective control over ChinaGohi. Accordingly, the operating results of ChinaGohi have been consolidated with those of the Company starting December 19, 2005. 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$4,500,000 for 15 months ending December 31, 2006 is available. Accordingly, the contingent consideration of 687,500 restricted shares and cash of US$1,325,000 have not been reflected in the consolidated financial statements of the Company as of December 31, 2005.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE YEAR ENDED DECEMBER 31, 2005 AND 2004

The following unaudited pro forma consolidated financial information for the years ended December 31, 2004 and 2005, as presented below, reflects the results of operations of the Company assuming the acquisition occurred on January 1, 2004 and 2005 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, 2004 and 2005 respectively, and may not be indicative of future operating results.

Lion Zone	**Year ended December 31**	
	2005	**2004**
	Restated	**Restated**
(In thousands of U.S Dollars)	**(Unaudited)**	**(Unaudited)**
Revenues	$ 44,177	$ n/a
Operating income	(25,563)	n/a
Net profit	(28,344)	n/a
Loss per share-basic&diluted	$ (2.79)	$ n/a

PacificNet included the financial results of Lion Zone in its consolidated 2005 financial results from the date of the purchase, December 19, 2005 through December 31, 2005.

3. INVESTMENT IN AFFILIATED COMPANIES

Investments

Investments in affiliated companies and subsidiaries consist of the following as of December 31, 2005 and 2004 (in thousands):

(USD000s)	2005	2004	COLLATERAL/OWNERSHIP % AND BUSINESS DESCRIPTION
INVESTMENTS IN AFFILIATED COMPANIES:			
Take1 (Cheer Era Limited) [1]	$ 1,161	$1,933	20% ownership interest in 2005 (30% in 2004); trader of vending machine located in Hong Kong
Shanghai Classic (Yueshen)	$1,438	$1,438	

			51% ownership interest in Yueshen thru Shanghai Classic (See note 2)
Ximedia Holdings Inc	95	95	25% ownership interest; provides new media business development and marketing to advertisers.
Less: Provisions for Impairment	(1,533)	(1,533)	
Total	$ 1,161	$1,933	

F-23

TAKE 1 TECHNOLOGIES GROUP LIMITED (FORMERLY KNOWN AS: CHEER ERA LIMITED "CHEERERA")

The investment in 30% of Take 1 Technologies Group Limited ("Take 1"), a trader of vending machine located in Hong Kong, was originally made in April 2004 with details as follows:

In April 2004 the Company, through its subsidiary PacificNet Strategic Investment Holdings Limited, acquired 30% equity interest in Take 1. The aggregate consideration was $385,604 in cash and 149,459 PacificNet shares , and warrants within a duration of three years to purchase up to 50,000 PacificNet shares at 5-Day volume weighted average price immediately prior to the transaction. The warrants have been cancelled in the year 2005 because the warranted profit was not met. (See Note 5)

In 2005 both the Company and Take 1 have mutually agreed to a change to the original investment structure pursuant to the Securities Repurchase Agreements entered. Summarized below are the effects of these repurchase arrangements:

(i) PacificNet 's interest in Take 1 was reduced to 20% in the year 2005 from 30% in the prior year;

(ii) PacificNet repurchased 149,459 shares in PacificNet previously issued to the majority owner of Take 1 at nominal value;

(iii) In addition to PacificNet 's existing loan of $769,000 (or HKD$6,000,000), PacificNet will advance a new loan of $256,000 (or HKD$2,000,000) to Take 1 (collectively called `Convertible Loan'). The Convertible Loan is guaranteed personally and jointly by the two majority owners of Take 1. The term of the Convertible Loan shall be three years expiring on October 17, 2008 (referred as "Term") with 8% interest per annum or HK Six-Month Prime Rate, whichever is higher.

(iv) Conversion terms of the Convertible Loan provide PacificNet an option at any time during the Term to convert in part or in whole of the then outstanding loan principal up toS$1,794,000 (or HKD$8,000,000) into shares of Take 1 to reach 51% ownership of Take 1.

As a result, the original investment of Take 1 was reduced at cost to $385,604 as of December 31, 2005 due to the PacificNet shares repurchased under item (ii) above. As of December 31, 2005, the outstanding loan amount due to Take 1 was US$769,000.

4. PROPERTY AND EQUIPMENT, NET

Property and equipment consists of the following as of December 31 (in thousands of US dollars)

	FY2005 Restated	FY2004 Restated
Office furniture, fixtures and leasehold improvements	$ 1,173	$ 1,005
Computers and office equipment	5,623	2,371
Motor Vehicles	354	58
Software	755	613
Electronic Equipment	2,143	1,178
Land and buildings	68	
Other	233	68

Less: Accumulated depreciation	(6,662)	(4,572)
Net Property and Equipment	$ 3,687	$ 721

For the years ended December 31, 2005 and 2004, the total depreciation and amortization expenses were $351,000 and $103,000 respectively, which were all included in the cost of revenue.

5. COMMITMENTS AND CONTINGENCIES

OPERATING LEASES - The Company leases warehouse and office space under operating leases for two years with fixed monthly rentals that expire through 2005. None of the leases included contingent rentals. Lease expense charged to operations for 2005 amounted to $516,000 (2004: $383,000). Future minimum lease payments under non-cancelable operating leases are 2006: $571,000 and 2007: $680,000. 2008-2009 $764,000

RESTRICTED CASH –The Company has a $163,000 and 212,000 pledged bank deposit for Epro which represents overdraft protections with certain financial institutions for the years ended December 31, 2005 and 2004 respectively.

BANK LINE OF CREDIT (2005): As of December 31, 2005, the Company utilized $1,059,000 of the banking facility including $944,000 from Epro and $115,000 from Smartime. Epro has an overdraft banking facility with certain major financial institutions in the aggregate amount of $1,218,000, which is secured by a pledge of its fixed deposits of $163,000, pursuant to the following terms: interest will be charged at the Hong Kong Prime Rate per annum and payable at the end of each calendar month or the date of settlement, whichever is earlier. For Smartime, there is no due date payment stipulated by Hong Kong Hang Seng Bank because its overdraft banking facility was borrowed directly from one of its directors personal fixed deposit account as a mortgage. The detailed payment period is based on its funding condition.

As at December 31, 2004 the Company utilized 196,000 of the banking facility including $78,000 from Epro and $118,000 from Smartime, Epro is secured by a pledge of the Company's fixed deposits of $212,000, pursuant to the following terms: interest will be charged at the Hong Kong Prime Rate per annum and payable at the end of each calendar month or the date of settlement, whichever is earlier. For Smartime, there is no due date payment stipulated by Hong Kong Hang Seng Bank because its overdraft banking facility was borrowed directly from one of its directors personal fixed deposit account as a mortgage. The detailed payment period is based on its funding condition.

CONTINGENT CONSIDERATION: Warrants have not been included as part of the acquisition price of various S&P Agreements (Note 2) and are no longer considered as part of the purchase consideration due to (i) the ambiguity of the S&P Agreements with respect to the issuance of the warrants and (ii) the lack of actual instruments to transfer the warrants, such as a warrant agreement that is signed and sealed by the Company and property registered at the Company Registrar of securities in Hong Kong, and accordingly, there is no irrevocable obligation by the Company to issue the warrants. Furthermore, the net income milestones were not achieved as required under the S&P Agreements according to Hong Kong law. Based on the opinion of the Company's legal counsel in Hong Kong, the Company does not have an irrevocable obligation to issue the warrants and therefore the warrants are not considered issued and outstanding. The offer to issue the warrants is no longer part of the purchase price in the S&P Agreements due to the failure by the Sellers to satisfy their warranties in the S&P Agreements. Accordingly, the warrants have not been valued.

MINIMUM STATED CAPITAL REQUIREMENTS. Guangzhou Dianxun Co, Limited (DE) ("Dianxun"), a subsidiary of the Group, is carrying on business as a telecommunication value added service provider in the People's Republic of China ("PRC"). Initially, Dianxun obtained a certificate (the "Certificate") from the PRC authority to transact business and according to the PRC Telecommunication Rules, all telecommunication value added service providers can only carry on business if the Certificate is granted and if the Company maintains a minimum capital requirement of at least RMB10,000,000

In order to satisfy the capital requirement of RMB 10,000,000, the shareholders of Dianxun had contributed relevant asset equivalent to RMB9,000,000 on behalf of Dianxun and such assets were verified by an independent professional accountant. Subsequently, such assets were returned back to the shareholders. In the opinion of the directors, even though the capital requirement is not fulfilled, Dianxun can continue to carry on business. No provision for any loss

arising from the consequential actions that may be taken by the authority in the PRC and any potential penalties or claims for the Company not maintaining the minimum stated capital requirements of the PRC have been made in these financial statements.

Dianxun's contribution to consolidated revenues and net profit for 2005 was approximately 2% and 0%, respectively. Upon demand by the PRC authorities, PacificNet has agreed to loan Clickcom the remaining balance of the registration capital to provide the stated capital in accordance with PRC laws.

F-25

---

6. OTHER CURRENT ASSETS

Other current assets are represented in Consolidated Balance Sheets which include the following as at December 31 (in thousands of US Dollars):

Other current assets	2005 **Restated**	2004 **Restated**
Prepayment	$ 1,108	$ 211
Utilities deposit	12	-
Prepaid expenses	1,059	142
Income tax refunds	-	22
Others receivable	4,049	1,590
Provision for doubtful account of other receivables	(1,031)	(356)
Total	$ 5,197	$ 1,609

7. BANK LOANS

Bank loans represent the following at December 31 (in thousands of US Dollars):

Bank loans	**2005 Restated**	**2004 Restated**
Secured [1]	$ 108	$ 757
Unsecured	86	890
Less: current portion	(188)	(1,577)
Non current portion	$ 6	$ 70

Bank Loans are generated by one of the Company's subsidiaries, PacificNet Epro Holdings Limited, a company incorporated in the Hong Kong Special Administrative Region of the PRC, primarily engaged in the business of providing call center and customer relationship management (CRM) services as well as other business outsourcing services.

[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 $163,000 (2004: $212,000) of a subsidiary of the Company.

Aggregate future maturities of borrowing for the next five years are as follows: (2006: $188,000, 2007: $6,000)

8. CAPITAL LEASE OBLIGATIONS

The Company leases various equipments under capital leases expiring in various years through 2008. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the asset. The assets are depreciated over the lesser of their related lease terms or their estimated productive lives and are secured by the assets themselves. Depreciation of assets under capital leases is included in depreciation expense for 2005 and 2004.

Aggregate minimum future lease payments under capital leases as of December 31, 2005 for each of the next five years are as follows: (2006: $126,000; 2007: $57,000; and 2008: $21,000)

Capital lease obligations represent the following at December 31 (in thousands of US Dollars):

Capital lease obligations	2005 Restated	2004 Restated
Total minimum lease payments	$ 216	$ 225
Interest expense relating to future periods	(12)	(16)
Present value of the minimum lease payments	204	209
Less: current portion	(126)	(99)
Non current portion	$ 78	$ 110

Following is a summary of fixed assets held under capital leases at December 31 (in thousands of US Dollars):

	2005 Restated	2004 Restated
Computers and office equipment	$ 636	$ 571
Less: accumulated depreciation	(475)	(359)
Net	$ 161	$ 212

9. ACCRUED EXPENSES& OTHER PAYABLES

Accrued expenses consist of the following at December 31 (in thousands of US Dollars):

Accrued expenses & other payables	2005 Restated	2004 Restated
Deposit received from customers	$ 5,280	$ 318
Accrued expenses	1,249	377
Salaries and benefit payable	1,267	149
Others	211	107
Total	$ 8,007	$ 951

10. SUNDRY INCOME

Sundry income for the years ended December 31, 2005 and 2004 was comprised of the following on the consolidated income statements (in thousands of US dollars).

Sundry income	2005 Restated	2004 Restated
Consulting service income	$ (368)	$ (345)
Investment income	(260)	(55)
Leasehold income	(6)	(104)
Others	(21)	(17)
TOTAL	$ (655)	$ (521)

11. STOCKHOLDERS' EQUITY

a) COMMON STOCK

For the year ended December 31, 2005, the Company had the following equity transactions (i) 700,000 shares as a result of exercise of stock options and warrants with cash consideration of $966,000; (ii) 515,900 shares for acquisition of subsidiaries valued at $3,971,000;(iii) 20,000 shares at $63,000 for investor relations services rendered based on the fair market value of the services rendered; (iv) repurchase of 45,000 shares fraudulently issued by the former financial controller of the company in 2004 to herself at par value; and (v) repurchase of 149,459 shares with a market value of $1,547,000 related to affiliated company (see Note 3 for details).

For the year ended December 31, 2004, the Company had the following equity transactions (i) 219,364 shares as a result of exercise of stock options and warrants with cash consideration of $606,000; (ii) 1,756,240 shares for acquisition of subsidiaries valued at $9,938,000; and (iii) 2,205,697 shares for cash proceeds of $12,330,000 (net of offering costs); (iv) 50,000 shares at $2.64 per share, or $132,000 for investor relations services rendered; (v) 83,000 shares were fraudulently issued by the former financial controller of the company to herself out of which 38,000 could not be cancelled as they had been resold and the balance were cancelled in 2005 by the company; and (vi) 149,459 shares with a market value of $1,547,000 for acquisition of affiliated company (see Note 3 for details)

b) STOCK OPTION PLAN

On December 23, 2003, stockholders of the Company adopted an amendment to the Stock Option Plan (the "Plan") to increase the number of shares reserved under the Plan from 1,666,667 to 2,000,000. On December 30, 2004, stockholders of the Company approved the new 2005 Stock Option Plan (the "2005 Option Plan"). The 2005 Option Plan provide for the grant to directors, officers, employees and consultants of the Company (including its subsidiaries) of options to purchase up to an aggregate of 2,000,000 shares of Common Stock. The 2005 Plan is administered by the Board of Directors or a committee of the Board of Directors (in either case, the "Committee"), which has complete discretion to select the optionees and to establish the terms and conditions of each option, subject to the provisions of the 2005 Option Plan. Options granted under the 2005 Plan are "incentive stock options" as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or nonqualified options.

The purpose of the Plan is to attract and retain the best available personnel for positions of responsibility and to provide incentives to such personnel to promote the success of the business. The Plan provides for the grant to directors, officers, employees and consultants of the Company (including its subsidiaries) of options to purchase shares of common stock. Options granted under the Plan may be "incentive stock options" as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or non-qualified options. To date, all options granted have been nonqualified options. The exercise price of incentive stock options may not be less than 100% of the fair market value of the common stock as of the date of grant. The number of options outstanding and the exercise price thereof are subject to adjustment in the case of certain transactions such as mergers, recapitalizations, stock splits or stock dividends. Options granted under the Plan fully vest through June 2006.

The status of the Stock Option Plan as of December 31, 2005, is as follows:

	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
OUTSTANDING, DECEMBER 31, 2003	550,600	$ 2.87
Granted	870,000	$ 3.03
Cancelled	(400,000)	4.25

Exercised	(188,500)	$	2.04
OUTSTANDING, DECEMBER 31, 2004	832,100	$	1.90
Granted	680,000	$	6.57
Cancelled	(680,000)	$	6.57
Exercised	(76,000)	$	2.05
OUTSTANDING, DECEMBER 31, 2005	756,100	$	3.99

Additional information on options outstanding as of December 31, 2005 is as follows:

	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	AVERAGE REMAINING CONTRACTUAL LIFE
Options outstanding	$3.99	756,100	3.50 years
Options exercisable	$2.06	529,000	1.50 years

c) WARRANTS

At December 31, 2005, the Company had outstanding and exercisable warrants to purchase an aggregate of 591,138 shares of common stock. The weighted average remaining life is 3.74 years and the weighted average price per share is $9.50 per share as follows:

The status of the warrants as of December 31, 2005, is as follows:

	WARRANTS		WEIGHTED AVERAGE EXERCISE PRICE
OUTSTANDING, DECEMBER 31, 2003	800,000	$	1.53
Granted	622,002	$	9.38
Expired	-		-
Exercised	(30,864)	$	7.15
OUTSTANDING, DECEMBER 31, 2004	1,391,138	$	4.93
Granted	-		-
Expired	(200,000)	$	1.75
Exercised	(600,000)	$	1.45
OUTSTANDING, DECEMBER 31, 2005	591,138	$	9.5

Following is the details of warrants outstanding as of December 31, 2005

Grant Date	Total warrants Outstanding	Weighted Average Remaining Life (Years)	Total Weighted Average Exercise Price	Warrants Exercisable	Weighted Average Exercise Price
January 15, 2004	123,456	3.04	$7.15	123,456	$7.15
November 17, 2004	117,682	3.88	$3.89	117,682	$3.89
December 9, 2004	350,000	3.94	$12.21	350,000	$12.21
Total	591,138	3.74	$9.50	591,138	$9.50

The Company believes 330,000 warrants issued in connection with certain acquisition agreements (Note 2) with the following subsidiaries, Yueshen: 50,000, Cheer Era: 80,000, Smartime: 50,000, Clickcom: 50,000, and Guangzhou3G:100,000 were no longer part of the purchase consideration as more fully described in Note 5 and therefore are not considered outstanding.

During 2005, 200,000 unexercised warrants (Excel Harbour warrants) expired, and 600,000 warrants were exercised by Sino Mart Management Ltd, a related party, at an exercise price of $1.45 per share for total proceeds of $870,000. For the year ended December 31, 2004, 30,864 warrants were exercised at an exercise price of $7.15 per share for total proceeds of $220,678.

d) TREASURY STOCK

The following is a summary of the movement of the Company's shares held as treasury stock for the years ended December 31:

	Number of shares	**Remarks**
Balance, December 31, 2003	800,000	
Repurchase in the open market	33,616	
Balance, December 31, 2004	833,616	
Repurchase in the open market	2,000	
Repurchase of shares from Take1	149,459	See note 3 to the F/S
Cancellation of former employee shares	45,000	
Holdback shares as contingent consideration due to performance targets not yet met	298,550	Including 24,000 shares relating to options exercised but neither money received nor shares issued, 196,350 shares to 3G and 78,000 shares to Clickcom, 200 other shares
Share consideration for acqusition of ChinaGoHi deemed issued under Sale and Purchase Agreement	(137,500)	Due to share issuance in progress; actual share certificate delivered after the year end
Balance, December 31, 2005	1,191,125	
Shares outstanding at December 31, 2005	10,809,562	
Shares issued at December 31, 2005	12,000,687	

12. INCOME TAXES

The Company is registered in the State of Delaware and has operations in primarily three tax jurisdictions - the PRC, Hong Kong and the United States.

United States of America

For operations in the USA, the Company is subject to United States federal income tax at a rate of 34%. The Company has incurred net accumulated operating losses for income tax purposes and there is no provision for U.S. federal income tax for 2005 and 2004 due to the Company's loss position. The Company believes that it is more likely than not that these net accumulated operating losses will not be utilized in the future because the Parent company is a holding company with foreign subsidiaries and does not generate income. Therefore, the Company has provided full valuation allowance for the deferred tax assets arising from the losses as of December 31, 2005 and 2004.

The following table sets forth the significant components of the deferred tax assets for operation in the United States of America as of December 31, 2005 and 2004.

	2005	2004
Deferred tax asset credit:		
Federal	34%	34%
State	6%	6%
Valuation allowance	(40)%	(40)%

	0%	0%

The following is a reconciliation of the provision for income taxes at the U.S. federal income tax rate to the income taxes reflected in the Statement of Operations:

	2005	2004
U.S federal tax rate	34%	34%
State tax rate	6%	6%
Valuation allowance	(40)%	(40)%
	0%	0%

The Company generates substantially all of its net income from its Hong Kong and PRC operations and the Company has recorded income tax provisions for the years ended December 31, 2005 and 2004. The tax laws for these jurisdictions are summarized as follows:

Hong Kong

Hong Kong profits tax has been provided at a rate of 17.5% on the estimated assessable profits arising in Hong Kong for each of the years ended December 31, 2005 and 2004. Provision for Hong Kong profits tax for 2005 was approximately $40,000 (2004 $36,000).

PEOPLE'S REPUBLIC OF CHINA (PRC)

Pursuant to the PRC Income Tax Laws, the Company's subsidiaries and VIEs are generally subject to Enterprise Income Taxes ("EIT") at a statutory rate of 33%, which comprises 30% national income tax and 3% local income tax. Some of these subsidiaries and VIEs are qualified new technology enterprises and under PRC Income Tax Laws, they are subject to a preferential tax rate of 15%. In addition, some of the Company's subsidiaries are Foreign Investment Enterprises and under PRC Income Tax Laws, they are entitled to either a three-year tax exemption followed by three years with a 50% reduction in the tax rate, commencing the first operating year, or a two-year tax exemption followed by three years with a 50% reduction in the tax rate, commencing the first profitable year. Provision for PRC business tax expense for 2005 was $232,000 (2004: $70,000).

No provision for deferred tax liabilities has been made, since the Company had no material temporary differences between the tax bases of assets and liabilities and their carrying amounts.

13. RELATED PARTY TRANSACTIONS

Employment Agreement

The Company has an employment agreement with its Chief Executive Officer (CEO) and President. The employment agreement with the CEO provides for $100,000 cash compensation plus $60,000 annual share compensation until April 1, 2005. The CEO is also eligible for an annual bonus for each fiscal year of the Company during the term based on performance standards as the Board or compensation committee designates. The CEO is entitled to receive a monthly housing allowance of $2,500, monthly automobile allowance of $500, Tax Preparation expenses of $2,000 per year, and Cash Bonus based on net profit of the Company. During 2004, under the Company’s stock option plan, the CEO was granted an option to acquire 65,000 shares at an exercise price per share of $2.00 (at market price) which has not been exercised. During 2004, under the Company’s stock option plan, the President was granted an option to acquire 73,000 shares at an exercise price per share of $2.00 (at market price) which has not been exercised.

Lease Agreement

In November 2004, the Company entered 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 TO AND FROM RELATED PARTIES

As at December 31, 2005 and 2004, there was a total loan receivable of approximately $2,328,000 and $1,460,000 respectively due from related parties while the loan due to related party was $759,000 and $184,000.

As at December 31, 2005 the related party loans receivable included $769,000 due from Take 1, an affiliated company that is 20% owned by PacificNet Strategic Limited. The loans receivable from shareholders and directors of PacificNet's subsidiaries comprised of $1,559,000 due from a shareholder of Smartim and Yueshen.

As at December 31, 2004, the related party loans receivable included $320,000 due from Take 1, an affiliated company that is 20% owned by PacificNet Strategic Limited. The loans receivable from shareholders and directors of PacificNet's subsidiaries comprised of $1,140,000 due from a shareholder of Yueshen.

The terms of these three related party loans receivable and payable are summarized below:

LOAN TO TAKE 1

Please refer to Note 3 of the Consolidated Financial Statements for detailed discussion on the change of investment structure of this affiliated company which is now 20% owned by PacificNet Strategic Limited. As at years ended December 31, 2005 and 2004, there was a Convertible Loan of $769,000 and $320,000 respectively outstanding from Take 1. The purpose of the Convertible Loan was a working capital loan to finance the expansion of Take 1's business in Europe and North America.

LOAN TO SMARTIME'S SHAREHOLDER

As at December 31, 2005, there was $192,000 loan receivable due from the shareholder of PacificNet Smartime.

LOAN TO SHAREHOLDER OF YUESHEN

As at December 31, 2005 and 2004, there was an unsecured loan of $1,367,000 and $1,140,000 respectively due from Ms. Li Yan-Kuan, shareholder of Yueshen.

LOAN PAYABLE TO RELATED PARTY

As at December 31, 2005, a loan of $513,000 was payable to a shareholder of EPRO. The loan was advanced to Epro for working capital purpose expiring by August 4, 2010 at Hong Kong Prime lending rate approximately 6.5% interest per annum prevailing in the year 2005.

As at years ended December 31, 2005 and 2004, a loan of $246,000 and $184,000 respectively was payable to a shareholder of Yueshen.

14. SEGMENT INFORMATION

SFAS No. 131, DISCLOSURE ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION ("SFAS 131"), establishes standards for reporting information about operating segments and for related disclosures about products, services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in making decisions regarding allocation of resources and assessing performance. PacificNet's chief decision-makers, as defined under SFAS 131, is the Chief Executive Officer and Chairman. During 2005 and 2004, PacificNet had four operating segments.

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 profit (loss), income and expense not allocated to reportable segments.

For the year ended December 31, 2005 (in thousands of US Dollars, except percentages)	Group 1. Outsourcing Business ($) Restated	Group 2. Value-Added Telecom Business ($) Restated	Group 3. Communication Products Distribution Business ($) Restated	Group 4. Other Business ($) Restated	Total ($) Restated
Revenues	13,568	13,779	2,880	859	31,086
(% of Total Revenues)	44%	44%	9%	3%	100%
Earnings / (Loss) from Operations	686	1,274	(106)	(6,187)	(4,333)
(% of Total Profit)	(16)%	(29)%	2%	143%	100%
Total Assets	8,100	18,783	7,036	12,432	46,351
(% of Total Assets)	17%	41%	15%	27%	100%
Goodwill	3,964	5,165			9,129
Geographic Area	HK,PRC	HK, PRC	HK,PRC,Macau	HK,PRC	

For the year ended December 31, 2004 (in thousands of US Dollars, except percentages)	Group 1. Outsourcing Business ($) Restated	Group 2. Value-Added Telecom Business ($) Restated	Group 3. Communication Products Distribution Business ($) Restated	Group 4. Other Business ($) Restated	Total ($) Restated
Revenues	9,821	6,084	849	188	16,942
(% of Total Revenues)	58%	36%	5%	1%	100%
Earnings / (Loss) from Operations	862	1,655	(287)	(6,818)	(4,588)
(% of Total Profit)	(19%)	(36%)	6%	149%	100%
Total Assets	4,671	3,684	6,725	14,917	29,997
(% of Total Assets)	16%	12%	22%	50%	100%
Goodwill	3,964	3,672			7,636
Geographic Area	HK,PRC	HK, PRC	HK,PRC,Macau	HK,PRC	

The Company identifies and classifies its operating segments based on 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 operating segments are classified into four major segments which are summarized 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) Value-Added Telecom Ser vices (VAS) – primarily involves machine voice services such as Interactive Voice Response, SMS and related VAS, which are conducted through our subsidiaries such as ChinaGoHi, Linkhead, Clickcom 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) Communication and Gaming Products Group – primarily involves voice products distribution such as distribution of calling cards and Gaming products. These calling cards differ from the phone cards in the VAS business as these cards are geared towards the end user, and include prepaid calling cards, IDD long distance calling cards, internet access cards, bundled cross-selling insurance cards, and shopping discount cards.

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

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

For the year ended December 31, 2005	Hong Kong	PRC	Macau	United States	Total
Product revenues-Restated	3,216	6,788			10,004
Service revenues-Restated	10,413	10,669			21,082

For the year ended December 31, 2004	Hong Kong	PRC	Macau	United States	Total
Product revenues-Restated	849	6,085			6,933
Service revenues-Restated	9,168	841			10,008

15. EVENTS SUBSEQUENT TO DECEMBER 31, 2005 (UNAUDITED)

1) SALE OF CONVERTIBLE DEBENTURES

On March 13, 2006, the Registrant consummated a private offering of $8,000,000 principal amount variable debentures due March 2009 (the Debentures) at an initial fixed conversion price of $10.00, and warrants to purchase up to 400,000 shares of the Registrants common stock exercisable for a period of 5 years at an exercise price of $12.20 per share (the Warrants) with several institutional investors, which included Whalehaven Capital Fund Limited, DKR Soundshore Oasis Holding Fund Ltd., Basso Fund Ltd., Basso Multi-Strategy Holding Fund Ltd., Basso Private Opportunities Holding Fund Ltd., Iroquois Master Fund Ltd., C.E. Unterberg, Towbin Capital Partners I, LP and Alpha Capital AG. C.E. Unterberg, Towbin advised the Registrant and acted as lead placement agent.

The Registrant has agreed to file a registration statement covering the resale of the shares underlying the Debentures and the Warrants under the Securities Act of 1933, as amended, on the earlier of (i) April 30, 2006, or (ii) the 30th calendar day following the date the Registrant files its Form 10-KSB with the Securities and Exchange Commission.

The Debentures and Warrants were sold in a transaction not involving a public offering and were issued without registration in reliance upon the exemption from registration afforded by Section 4(2) of the Securities Act of 1933, as amended and Regulation D promulgated there under.

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 remains in full force and effect.

EVENT OF DEFAULT

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

2) SALE OF CONVERTIBLE DEBENTURES BY OUR SUBSIDIARY PACIFICNET GAMES LIMITED

On February 9, 2007, the Company through its subsidiary, PacificNet Games Limited (PacGames) entered into a definitive agreement for a $5 million financing in the form of a convertible secured note from Pope Asset Management, LLC (Pope), an institutional investor. Proceeds from the financing will be used 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 financing, evidenced by a convertible secured note issued by PacGames to Pope, matures on February 6, 2010, and may be converted into 26% to 32% ownership interest in PacGames based on reaching certain net income milestones during fiscal year 2007. The interest rate on the convertible debenture isl initially set at 8%, and shall increase to 15% if the note is not converted prior to maturity.

3) SALE OF GUANGZHOU YUESHEN TAIYANG NETWORK SCIENCE AND TECHNOLOGY LIMITED (“Yueshen”)

Operations of Yuenshen were discontinued during the year. Accordingly, the Company had recorded a charge to loss on disposal of $0.5 million at December 31, 2006.On 12 August, 2006, to recover the loan advanced to Yueshen, we commenced a law suit in the High Court of the Hong Kong Special Administrative Region ("HKSAR") against i) Guangzhou Yueshen Taiyang Network Science and Technology Limited as borrower and both ii) Ms. Li Yan Kuan and iii) Mr. Yi Wen as guarantors for the loan sum of RMB 2,000,000 ("Debt Sum") together with the agreed interest rate calculated at 6% per annum all due on 15 November, 2005 according to the promissory note and guarantee entered into by the three defendants on 15 May, 2005.

4) SALE OF GUANGZHOU CLICKOM DIGIT-NET SCIENCE AND TECHNOLOGY LTD. (“Clickcom”)

Operations of Clickcom were discontinued and became dormant during the year as a result of poor business and market prospects. Former staffs of Clickcom have been reassigned to MOABC. Nominal amount of fixed assets are subject to disposition. Accordingly, Clickcom has been classified as Asset Held for Disposition in 2006.

5) SALE OF CHINAGOHAI (“Lion Zone”)

On November 20, 2006, PacificNet executed an agreement ("Termination Agreement") to terminate the Sale and Purchase Agreement with Lion Zone, ChinaGoHi and Mr. Wang Wenming (collectively, the "Sellers"). The Termination Agreement was effective as of November 1, 2006. In the Termination Agreement, the Sellers agreed to pay an aggregate of HKD$3,000,000, comprising: USD$100,000 in cash and 275,000 in restricted shares of PACT, in exchange for 51% interest of Lion Zone, holding company of ChinaGoHi. Additionally, the Sellers agreed to waive PacificNet's obligations under the Sale and Purchase Agreement entered into between PacificNet and the Sellers in

December 2005 to issue restricted shares and to provide certain loans to the Sellers. PacificNet, however, reserves the rights to re-purchase the said 51% interest of Lion Zone within 2 years of the date of signing the Termination Agreement for a consideration of 5 times audited net profit under US GAAP for the 12-month period subsequent to the year of signing.

6) SALE OF BEIJING LINKHEAD TECHNOLOGIES COMPANY LIMITED (“Linkhead”)

Due to bleak industry prospects, board of directors of Linkhead had resolved a special board resolution in January 2007 to direct management to engage in active search for willing buyers to acquire or prepare to enter into liquidation process. Accordingly, Linkhead has been classified as Asset Held for Disposition in 2006. Approximately $4 million of goodwill carried for Linkhead has been charged to impairment by the Company at the year end of 2006.

7) SALE OF GUANGZHOU 3G (“GZ3G”)

As part of our strategy to move away from telecom VAS, on April 30,2007 our wholly-owned subsidiary, PacificNet Strategic Investment Holdings Limited, entered into a stock purchase and sale agreement with Heyspace International Limited to sell its 51% interest in Guangzhou 3G's parent company, Pacific 3G Information & Technology Co. Limited. The purchase price is $6,000,000 payable in installments over a six month period or earlier if Heyspace completes its initial public offering prior to October 31, 2007.

8) SALE OF PACIFICNET TELECOM SOLUTIONS 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.

9) SALE OF 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.

10) SALE OF 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.

11) SALE OF 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.

12) ACQUISITION OF PACIFICNET IMOBILE (BEIJING) TECHNOLOGY CO.LTD ("IMOBILE")

On February 26, 2006, entered into an agreement to acquire a 51% majority interest in PacificNet iMobile (Beijing) Technology Co., Ltd ("iMobile"), one of the leading Internet information portal and e-commerce distributors for mobile phone a and accessories and mobile related value-added service providers in China. iMobile operates its e-commerce business via two Internet portals, "http://www.iMobile.com.cn" and "http://www.18900.com" and one WAP portal "17wap.com" for mobile phone browsing. In addition, iMobile's 18900.com operation is the designated Internet distributor for Motorola, Nokia, and NEC's mobile products in China.

The purchase consideration for 51% of the equity interest of iMobile is approximately US$1.8 million, which represents approximately seven times the anticipated future annual net income of iMobile. The purchase consideration is payable 14% in cash and 86% in restricted shares of PacificNet valued at $8 per share, or about 191,875 restricted shares. Under the purchase agreement, iMobile has committed to generate US$500,000 in annual net income. In the

event of a shortfall, the purchase price will be adjusted accordingly. PacificNet will also invest approximately RMB2 million (about US$250,000) in iMobile for general corporate and working capital purposes to support growth. The purchase price is payable upon achievement of certain quarterly earn-out targets based on net income.

13) ACQUISITION OF GUANGZHOU WANRONG INFORMATION TECHNOLOGY CO.LTD (GUANGZHOU WANRONG)

On Jan 31, 2006, the Company, through its subsidiary PacificNet Strategic Investment Holdings Limited, consummated the acquisition of a 51% controlling interest in Guangzhou Wanrong Information Technology Co. Limited (Guangzhou Wanrong), one of the leading value-added telecom service providers in China, located in PRC Guangzhou, The purchase consideration for 51% of the equity interest of Guangzhou Wanrong was approximately US$1.75million, payable 21% in cash and 79% in restricted shares of PacificNet common stock valued at $8 per share, or about 173,000 restricted shares. Under the purchase agreement, Guangzhou Wanrong has made a guarantee to generate US$500,000 in annual net income. In the event of a shortfall, the purchase price will be adjusted accordingly. PacificNet will also invest approximately RMB 3 million (or about US$370,000) in Guangzhou Wanrong for general corporate purposes. The purchase price is payable upon achievement of certain quarterly earn-out targets based on net income.

14) ACQUISITION OF PACIFICNET GAMES LIMITED (PACGAMES)

On August 3, 2006, PacificNet's wholly owned subsidiary PacificNet Games Limited ("PacGames", [______________]) completed the acquisition of 100% of Able Entertainment Technology Ltd., a leading gaming technology provider based in the Macau Special Administrative Region of China. Upon completion of this transaction, the Company owned 35% of PacificNet Games Limited. Under the purchase agreement, Able Entertainment Technology Ltd represented that is expects to generate an annual profit of USD $1,600,000 and will provide for an adjustment to the purchase price if PacGames does not achieve an annual net profit of USD $1,600,000 during the first 12-month period ended June 30, 2007, and USD $3,000,000 during the second 12-month period ended June 30, 2008.

The purchase price consideration is 200,000 restricted PACT shares in exchange for 100% of the issued and outstanding shares of Able Entertainment Technology Ltd. or a 35% ownership interest in PacGames. As of December 31, 2006, 40,000 total restricted shares of PacificNet had been issued for the acquisition and 160,000 shares were held back as contingent consideration payable upon completion of certain earnings criteria pursuant to the purchase agreement.

On September 22, 2006, PACT acquired another 10% of PacGames in exchange for 57,100 restricted shares of the Company's common stock. Those shares have been issued out according to sale and purchase agreement.

On November 9, 2006, we acquired an additional 6% interest in PacificNet Games Limited (PacGames) for a consideration of $504,000 (paid entirely with shares of PacificNet: 90,000 PACT Shares, valued at $5.60 per share, price on the day of transaction). Those shares have been issued out according to sale and purchase agreement. The company currently owns 51% of PacGames.

15) ACQUISITION OF TAKE1 TECHNOLOGIES LIMITED ("TAKE1")

On January 05, 2007, we entered into an agreement for PacificNet to exercise the option to acquire an additional 31% interest in Take1 Technologies Limited ("Take1") (formerly known as "CHEER ERA LIMITED"). The completion date for the new Securities Subscription Agreement was March 5, 2007, with a consideration of $721,887 (paid entirely with shares of PacificNet: 149,459 PACT Shares, valued at $4.83 per share). As a result, PacificNet has become the majority and controlling shareholder of Take1 with our ownership percentage increased from 20% to 51%.

16) LEGAL PROCEEDINGS

1. Legal Proceeding and Judgment Against Guangzhou Yueshen Taiyang Network Science and Technology Limited, Ms. Li Yan Kuan, and Mr.Wu Yi Wen

On August 12, 2006, we commenced a law suit in the High Court of the Hong Kong Special Administrative Region ("HKSAR") against Guangzhou Yueshen Taiyang Network Science and Technology Limited, Ms. Li Yan Kuan, (PRC ID: 440112195706120967, Residential Address: Room G6-305, West Garden, FuLiHuanShi, HuanShi West Road, LiWan District, Guangzhou, Guangdong, China) and Mr.Wu Yi Wen, (PRC ID: 440106196412220919, Residential Address: Room 906, Number 15, SiHeng Road Number 2, TianHe YuanChun, Guangzhou, Guangdong, China) for failure to pay amounts owed under a promissory note. On May 15, 2005, we loaned RMB2,000,000 ("Debt Sum") to Yueshen to cover operating costs, evidenced by a promissory note due on November 15, 2005. Ms. Kuan and Mr. Wen guaranteed repayment of the note by Yueshen. The Debt Sum together with the agreed interest rate calculated at 6% per annum was due on November 15, 2005.

On March 28, 2007, the High Court of HKSAR had adjudged that the three defendants should pay us the Debt Sum together with interest sum at the rate of 6% per annum from May 15, 2005 to March 28, 2007, and additional interest

charged at the rate of 5% per annum for the Debt Sum and accrued interest within 90 days overdue and thereafter at the judgment rate until payment and fixed costs of HK$3,405.

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 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 trane water-cooled chillers, together with energy saving performance (the "Chiller System"), at the Fortress Tower in Hong Kong.

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

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

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

The case is under review by Hong Kong High Court and we have not received any judgment from the High Court of the Hong Kong Special Administrative Region as of date of this report. We are currently proceeding with discovery and counter-claims, 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.

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

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

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

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

On April 23, 2007, we instructed our lawyers issued a letter to the Defendant requesting and demanding them, being the sub-contractor of the Construction and Replacement Works Contract, to take immediate rectification action within

seven days from the date of the said letter to (i) rectify and complete all outstanding defective works of the Construction and Replacement Works Contract; (ii) replace the water-cooled chiller plant and/or equipments which are not conformed with the requirements of the tender documents previously submitted by the Defendant to the Employer; and (iii) improve the poor performance of energy saving of the new water-cooled chiller plant so that it would conform with their guarantee made on 21 December, 2005 to PKL and the employer.

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

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

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

---

4. PacificNet Inc., v/s 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., complaining against non-payment of mandatory default amount on convertible debentures of $3,000,000 and $420,000.

As of October 2, 2007, the outstanding principal amount of the $3,000,000 debenture is $2,045,452 and accrued but unpaid interest amount is $30,682.

The mandatory default amount due to Iroquois Master Fund, Ltd. pursuant to amended debenture (as amended in February 2007) is $2,698,974 on $3,000,000 convertible debenture.

As of October 2, 2007, the outstanding principal amount of the $420,000 debenture is $420,000 and accrued but unpaid interest amount is $6,300.

The mandatory default amount due to Iroquois Master Fund, Ltd. is $554,190 on $420,000 convertible debenture.

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.

16. RESTATEMENT

On March 19, 2007 the 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. Independent investigation in this connection commissioned by our Audit Committee resulted in extra stock-based compensation charges of approximately $0.3 million, $1.2 million and $0.1 million to each of the years ended December 31, 2005, 2004 and 2003, respectively,. 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.

Below is the detailed effect of the restatement:

(In thousands of US Dollars)	2005 As reported	2005 As restated	2004 As reported	2004 As reported
Consolidated Balance Sheets:				
ASSETS:				
Current assets	$ 31,130	$ 28,784	$ 21,531	$ 19,707
Non-current assets	20,073	14,212	11,719	10,290
Total assets	$ 51,203	$ 42,996	$ 33,250	$ 29,997
LIABILITIES				
Current liabilities	$ 10,620	$ 11,675	$ 5,346	$ 4,061
Non-current liabilities	84	84	198	180
Total liabilities	10,704	11,759	5,544	4,241
STOCKHOLDERS' EQUITY				
Additional paid-in capital	$ 57,690	$ 61,979	$ 53,916	$ 57,730
Accumulated deficit	(25,990)	(38,627)	(28,479)	(33,482)

TOTAL STOCKHOLDERS' EQUITY		31,785		23,204		25,310		24,108
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	51,203	$	42,996	$	33,250	$	29,997
Consolidated Statements of Operations:								
Net revenue	$	44,341	$	31,086	$	29,709	$	16,942
Cost of sales		(33,439)		(20,678)		(24,704)		(12,286)
Gross profit		10,902		10,408		5,635		4,656
Selling, General and Administrative expenses		(6,333)		(10,419)		(3,698)		(5,267)
Stock-based compensation expenses		-		(282)		-		-1,246
Income/(loss) from operations		4,569		(4,333)		1,937		(4,588)
Income/(loss) before income taxes, minority interest and discontinued operations		5,645		(3,596)		2,438		(4,135)
Income/(loss) before discontinued operations		2,498		(5,145)		817		(5,425)
Net income available to common stockholders	$	2,489	$	(5,145)	$	774	$	(5,425)
Earnings/(loss) per common share:								
Basic	$	0.25	$	(0.51)	$	0.11	$	(0.78)
Diluted	$	0.23	$	(0.51)	$	0.09	$	(0.78)
Shares used in computing earnings per share:								
Basic		10,154,271		10,156,809		7,268,374		7,015,907
Diluted		10,701,211		10,156,809		8,241,996		7,015,907
Consolidated Statements of Cash Flows								
Net income (loss)	$	2,489	$	(5,145)	$	774	$	(5,425)
Stock-based compensation		-		282		-		1,246
Net cash provided by (used in) operating activities		9,250		11,843		(4,431)		(2,757)
Net cash used in investing activities		(6,199)		(9,799)		(4,265)		(1,611)
Net cash provided by (used in) financing activities		24		(946)		11,620		10,077
Effect of exchange rate on cash & cash equivalent		(260)		7		17		2
NET INCREASE IN CASH AND CASH EQUIVALENTS	$	2,815	$	1,105	$	2,941	$	5,711