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

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

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

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

FOR THE TRANSITION PERIOD FROM _________ TO __________

COMMISSION FILE NUMBER: 000-24985

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES o NO þ

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

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

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

As of May 30, 2007, there were 11,782,072 shares of the issuer’s common stock, par value $0.0001 per share, outstanding.

EXPLANATORY NOTE:

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

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

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

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ITEM 1. FINANCIAL STATEMENTS
PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands of United States dollars, except par values and share numbers)

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

Total liabilities		21,439		20,080
Minority interest in consolidated subsidiaries		4,206		2,869
Commitments and contingencies				
Stockholders' Equity:				
Preferred stock, par value $0.0001, Authorized 5,000,000 shares Issued and outstanding - none				
Common stock, par value $0.0001, Authorized 125,000,000 shares; Issued and outstanding: March 31, 2007: 14,355,041 shares issued, 11,782,072 outstanding December 31, 2006: 14,155,597 issued, 11,538,664 outstanding		1		1
Treasury stock, at cost (2007 Q1: 2,572,969 shares, 2006: 2,616,933 shares)		(145)		(272)
Additional paid-in capital		67,003		65,757
Cumulative other comprehensive income (loss)		(13)		(42)
Accumulated deficit		(50,782)		(51,090)
Less: stock subscription receivable		(484)		(377)
Total Stockholders' Equity		15,580		13,977
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	41,225	$	36,926

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

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

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

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

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

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

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

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

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

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

1. BASIS OF PRESENTATION

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

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

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

Reclassification - Certain prior period amounts have been reclassified to conform to the current period presentation.

Going Concern

As shown in the accompanying consolidated financial statements, the Company incurred accumulated losses of $50.8 million and $51.1 million as of March 31, 2007 and December 31, 2006, respectively. These matters raise substantial doubt about the Company’s ability to continue as a going concern.

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

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

On April 30, 2007, the Company entered into a sale and purchase agreement to dispose of its interest in Guangzhou3G for a consideration of US$6 million. The deal was subsequently reopened for renegotiation in November 2007 (See note 17).

On May 15 & 20, 2007, the Company entered into various definitive agreements to reduce its equity interests in certain unprofitable subsidiaries to 15%, namely: Linkhead, Clickcom, PacTelso, PacSo and PacPower (See note 17).

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2. RECENT PRONOUNCEMENTS

In March 2007, the Emerging Issues Task Force ("EITF") reached a consensus on issue number 06-10, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements," ("EITF 06-10"). EITF 06-10 provides guidance to help companies determine whether a liability for the postretirement benefit associated with a collateral assignment split-dollar life insurance arrangement should be recorded in accordance with either SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (if, in substance, a postretirement benefit plan exists), or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract). EITF 06-10 also provides guidance on how a company should recognize and measure the asset in a collateral assignment split-dollar life insurance contract. EITF 06-10 is effective for fiscal years beginning after December 15, 2007 (Novell's fiscal 2008), though early adoption is permitted. The management is currently evaluating the effect of this pronouncement on financial statements.

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

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

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

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

3. EARNINGS PER SHARE

Basic and diluted earnings or loss per share (EPS) amounts in the financial statements are computed in accordance with SFAS No. 128, "Earnings Per Share." Basic EPS is based on the weighted average number of common shares outstanding. Diluted EPS is based on the weighted average number of common shares outstanding plus dilutive common stock equivalents. Basic EPS is computed by dividing net income/loss available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period Diluted EPS is calculated by dividing net earnings by the weighted average number of common shares outstanding and other dilutive securities. Dilutive earnings per share for the period ended March 31, 2007 exclude the potential dilutive effect of 889,456 warrants because their impact would be anti-dilutive based on current market prices. 690,909 convertible debentures are tested by using if-converted method. The result shows when convertible debentures are included in the computation, diluted EPS increases. According to SFAS No.128, those convertible debentures are ignored in the computation of diluted EPS. All per share and per share information are adjusted retroactively to reflect stock splits and changes in par value.

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

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

4. OTHER CURRENT ASSETS

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

	March 31, 2007 Unaudited Restated	December 31, 2006 Audited Restated
Prepayment	$ 725	$ 1,048
Utilities deposit	1,326	1,292
Receivable from Lion Zone Holdings Ltd	385	485