PACIFICNET INC
Form S-1/A
November 13, 2006

As filed with the Securities and Exchange Commission on November 13, 2006

Registration No. 333-134127

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Amendment No. 1 to
Form S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

PacificNet Inc.
(Exact name of Registrant as specified in its charter)

Delaware	**3669**	**91-2118007**
(State or Other Jurisdiction of Incorporation or Organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number)*

23/F, Tower A, Timecourt, No.6 Shugang Xili
Chaoyang District, Beijing, China 100028
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

Tony Tong
Chief Executive Officer
PacificNet Inc.
23/F, Tower A, Timecourt, No.6 Shugang Xili
Chaoyang District, Beijing, China 100028
0086-10-59225000
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Mitchell S. Nussbaum, Esq.
Loeb & Loeb LLP
345 Park Avenue
New York, New York 10154

Approximate date of commencement of proposed sale to the public: From time to time after this Registration

Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. o

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CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered	Proposed maximum offering price per share	Proposed maximum aggregate offering price	Amount of registration fee
Common Stock, $.0001 par value per share	800,000(1)(2)	$ 10.00 (3)	$ 8,000,000	$ 856.00
Common Stock, $.0001 par value per share	416,000(2)(4)	$ 12.20 (5)	$ 5,075,200	$ 543.05
Common Stock, $.0001 par value per share	104,000(6)	$ 10.00 (7)	$ 1,040,000	$ 111.28
Common Stock, $.0001 par value per share	26,000	$ 7.49 (8)	$ 194,740	$ 20.84
Common Stock, $.0001 par value per share	400,000(9)	$ 10.00 (3)	$ 4,000,000	$ 428.00
Common Stock, $.0001 par value per share	208,000(9)	$ 12.20 (5)	$ 2,537,600	$ 271.52
Common Stock, $.0001 par value per share	52,000(9)	$ 10.00 (3)	$ 520,000	$ 55.64
TOTALS	2,006,000		$ 21,367,540	$ 2,286.33(10)

(1) Represents the shares of our common stock issuable upon conversion of convertible debentures due March 13, 2009.

(2) Pursuant to Rule 416 of the Securities Act of 1933, as amended, the shares of common stock offered hereby also include such presently indeterminate number of shares of our common stock as shall be issued by us to the selling shareholders as a result of stock splits, stock dividends or similar transactions.

(3) Estimated solely for purposes of calculating the registration fee in accordance with Rule 457(g) under the Securities Act of 1933, as amended, based on the higher of (a) the conversion price of the convertible debentures, (b) the offering price of securities of the same class included in this Registration Statement, or (c) the price of securities of the same class as determined using the average of the high and low prices, as reported on The Nasdaq National Market, within five business days of the filing of this Registration Statement.

(4) Represents shares of our common stock issuable upon the exercise of outstanding warrants.

(5) Estimated solely for purposes of calculating the registration fee in accordance with Rule 457(g) under the Securities Act of 1933, as amended, based on the higher of (a) the exercise price of the warrants, (b) the offering price of securities of the same class included in this Registration Statement, or (c) the price of securities of the same class as determined using the average of the high and low prices, as reported on The Nasdaq National Market, within five business days of the filing of this Registration Statement.

(6) Represents shares of our common stock that may be issued in the form of the payment of interest on the convertible debentures due March 13, 2009.

(7) Assuming the debentures remain outstanding for three years and based upon the higher of (a) the highest conversion price at which shares issuable as interest on the convertible debentures will be issued, (b) the offering price of securities of the same class included in this Registration Statement, or (c) the price of securities of the same class as determined using the average of the high and low prices, as reported on The Nasdaq National Market, within five

business days of the filing of this Registration Statement.

(8) Estimated solely for purposes of calculating the registration fee in accordance with Rule 457(c) under the Securities Act of 1933, as amended based on the average of the high and low prices, as reported on The Nasdaq National Market, within five business days of the filing of this Registration Statement.

(9) Under the terms of the registration rights agreement, we are required to register 150% of the shares of common stock issuable upon conversion of the debentures, the warrants, and interest on the convertible debentures.

(10) Previously paid.

Pursuant to Rule 429 under the Securities Act of 1933, the prospectus included in this registration statement is a combined prospectus relating also to Registration Statement No. 333-121792 previously filed by the registrant on Form SB-2 and declared effective on February 4, 2005. This Registration Statement, upon effectiveness, also constitutes Post-Effective Amendment No. 1 to Registration Statement No. 333-121792, and such post-effective amendment shall hereafter become effective concurrently with the effectiveness of this Registration Statement and in accordance with Section 8(c) of the Securities Act of 1933.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with section 8(a) of the Securities Act of 1933, as amended, or until the registration statement shall become effective on such date as the Commission, acting pursuant to said section 8(a), may determine.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. THE SELLING STOCKHOLDERS MAY NOT SELL THESE SECURITIES PUBLICLY UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IT IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

SUBJECT TO COMPLETION, DATED November __, 2006

PROSPECTUS

PACIFICNET INC.

3,152,228 Shares of Common Stock

This prospectus relates to the resale of up to 3,152,228 shares of our common stock being offered by the selling stockholders. Of the shares covered by this prospectus, 602,310 shares have been issued, 800,000 shares are issuable upon the conversion of convertible debentures, 985,918 shares are issuable upon the exercise of warrants, 104,000 shares may be issued for the payment of interest on the convertible debentures and 660,000 shares have been registered pursuant to our obligation in our registration rights agreement to register 150% of the shares of common stock issuable upon conversion of the debentures, warrants and interest on the debentures. Of the shares of common stock included in this prospectus, 1,152,228 of the shares were previously registered. We will not receive any proceeds from the sale of the shares of common stock by the selling stockholders. Assuming that all of the warrants held by the selling stockholders are exercised for cash, we will realize proceeds of approximately $10,606,647.

Our shares of common stock are traded on The Nasdaq Global Market under the symbol “PACT.” The last reported sale price of our common stock on November 7, 2006, was $5.76.

THIS INVESTMENT INVOLVES A HIGH DEGREE OF RISK. YOU SHOULD PURCHASE SHARES ONLY IF YOU CAN AFFORD A COMPLETE LOSS OF YOUR INVESTMENT. SEE “RISK FACTORS” BEGINNING ON PAGE 5 FOR A DISCUSSION OF RISKS APPLICABLE TO US AND AN INVESTMENT IN OUR COMMON STOCK.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED THESE SECURITIES, OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is November __, 2006.

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PROSPECTUS SUMMARY

This summary highlights selected information appearing elsewhere in this prospectus. While this summary highlights what we consider to be the most important information about us, you should carefully read this prospectus and the registration statement of which this prospectus is a part in their entirety before investing in our common stock, especially the risks of investing in our common stock, which we discuss later in "Risk Factors," and our financial statements and related notes beginning on page F-1. Unless the context requires otherwise, the words "we," "us" and "our" refer to PacificNet Inc.

About PacificNet Inc.

We were incorporated in the state of Delaware in 1987. Our business consists of four groups, all of which operate within the outsourcing and telecommunications industries in Asia, primarily Greater China, which includes the People's Republic of China (PRC), or mainland China, Hong Kong Special Administrative Region (HKSAR), Macau Special Administrative Region, and Taiwan. Through our subsidiaries we invest in and operate companies that 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 comprises 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). Our communication products distribution services include the wholesale and retail sale and distribution of calling cards in China, multimedia interactive self-service kiosk distribution and online mobile phone distribution. We also have a number of subsidiaries that we use primarily for administration, internal control and acquisition purposes. We intend to continue to grow our business by acquiring and managing growing technology and network communications businesses with established products and customers in Asia.

Our business process outsourcing services generate revenue from call center services, call center management software sales, and training and consulting. We invoice our call center clients monthly at per seat monthly rates, a base price plus commission per call, or a per hour charge rate, depending on the client's preference. Our call center software clients pay per license, for which there is usually a one-time charge on sale of the software and annual maintenance fees for service. We charge per project for our consulting and training services and for our telecom VAS, which are invoiced throughout the project. Our telecom VAS often includes a post-sale service contract for systems integration and consulting services for which we bill separately. Our communication products such as calling cards, kiosks and cell phones are sold cash-on-delivery.

Our clients include the leading telecom operators, banks, insurance, travel, marketing, and service companies, as well as telecom consumers, in Greater China. Clients include China Telecom, China Netcom, China Mobile, China Unicom, PCCW, Hutchison Telecom, CSL, SmarTone, Sunday, Swire Travel, Coca-Cola, SONY, Samsung, Motorola, Nokia, TNT Express, Huawei, TCL, Dun & Bradstreet, American Express, Bank of China, DBS, Hong Kong Government, and Hongkong Post. PacificNet employs over 2,000 staff in our various subsidiaries in China with offices in Hong Kong, Beijing, Shanghai, Shenzhen, and Guangzhou.

PacificNet's operations include the following four groups:

(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).

(3) Communication Products Distribution Services: including calling cards, GSM/ CDMA/ XiaoLingTong products, and multimedia self-service kiosks.

(4) Other Business Services: including internal administrative matters and other related corporate items.

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Private Placement of Convertible Debentures and Warrants

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

Under the terms of the registration rights agreement, dated February 28, 2006, entered into among the Company and the holders, we are obligated to register for resale 150% of the shares of common stock issuable upon conversion of the debentures and the warrants, and interest on the convertible debentures. We are currently in default under the private placement transaction documents for the untimely filing of the registration statement, of which this prospectus is part, and for the failure to have the registration statement declared effective prior to the effectiveness date set forth in the registration rights agreement. As of November 1, 2006, we could be liable for liquidated damages of approximately $800,000 as a result of the foregoing. As of the date of this prospectus, the holders have not elected to accelerate the payment of the outstanding principal and interest owing on the debenture.

Also in connection with the private placement, Messrs. Tony Tong, Victor Tong and Shaojian Wang and Sino Mart Management Ltd., and its sole officer and director, Mr. Cho Sam Tong, entered into lock-up agreements restricting the disposition of shares of our common stock benefically owned by them until the earlier of 30 days from the effective date of the registration statement, or February 28, 2008.

Messrs. Tony and Victor Tong, Wang and Sino Mart Management Ltd. each executed letter agreements to the holders of the convertible debentures and warrants, in which they each agreed to vote all of the shares of the Company over which they have voting control in favor of any resolutions presented to the stockholders of the Company to approve the issuance, in the aggregate, of more than 19.999% of the number of shares of common stock of the Company outstanding on the closing date of the private placement. They executed each letter agreement in consideration of, and as a condition to the consummation of the private placement.

C.E. Unterberg, Towbin L.L.C. acted as Placement Agent and received a cash fee in the amount of $449,500 and a warrant to purchase up to 16,000 shares. Maxim Group also acted as Placement Agent and received a cash fee in the amount of $50,000.

SUMMARY CONSOLIDATED FINANCIAL DATA

The following table summarizes the relevant financial data for our business and should be read with our financial statements, which appear elsewhere in this prospectus.

CONSOLIDATED STATEMENT OF OPERATIONS DATA

	Six months ended June 30,		Year Ended December 31,				
	2006(unaudited)	2005(unaudited)	2005	2004	2003	2002	2001
Statement of Operations Data:							
Revenues	34,364	21,492	$ 44,341	$ 29,709	$ 1,217	$ 2,319	$ 961
Cost of revenues	(22,960)	(17,127)	(33,439)	(24,074)	(698)	(1,787)	(803)
Gross margin	11,404	4,365	10,902	5,635	519	532	158
Operating expenses: selling, general and administrative	(7,719)	(2,399)	(6,104)	(3,513)	(1,856)	(3,176)	(4,044)
Interest expense	(456)	-	(229)	(185)	-	-	-
Earnings/(Loss) from operations	3,229	1,966	4,569	1,937	(1,337)	(2,644)	(3,886)
Interest income	81		246	79	27	33	187
Other income	286	406	830	422	54	-	-
Changes in fair value of derivatives	208	-	-	-	-	-	-
Provision for impairment losses in affiliated companies	-	-	-	-	-	(97)	(1,093)
Earnings before income tax, minority interests and discontinued operations	3,804	2,372	5,645	2,438	(1,256)	(2,708)	(4,792)
Provision for Income Tax	(200)	(64)	(222)	(30)	(32)	-	-
Share of earnings of associated company	49	4	(8)	32	-	-	(34)
Loss from discontinued operations	-	-	-	(43)	-	(107)	(179)
Minority Interests	(1,934)	(1,304)	(2,926)	(1,623)	7	(106)	-
Net earnings available to common stockholders	1,719	1,008	2,489	774	(1,281)	(2,921)	(5,005)
Continuing Operations:	0.18	0.10	0.25	0.11	(0.24)	(0.67)	(2.99)

Basic earnings/(loss) per share							
Diluted earnings/(loss) per share	0.16	0.10	0.23	0.09	(0.24)	(0.67)	(2.99)
Discontinued Operations:							
Basic earnings/(loss) per share	-	-	-	-	-	(0.03)	(0.11)
Diluted earnings/(loss) per share	-	-	-	-	-	(0.03)	(0.11)

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CONSOLIDATED BALANCE SHEET DATA

	As of June 30, 2006		As of December 31,				
	2006	2005	2005	2004	2003	2002	2001
Balance Sheet Data:							
Cash and cash equivalents	$ 5,935	$ 5,569	$ 9,579	$ 6,764	$ 3,823	$ 3,694	$ 1,344
Accounts receivable	16,112	8,307	5,998	5,644	1,890	220	199
Property and equipment, net	8,361	4,477	4,300	1,118	466	284	332
Total assets	66,457	43,017	51,203	33,250	7,770	4,314	2,555
Total current liabilities	9,030	7,457	10,620	5,346	4,845	930	840
Total liabilities	18,517	8,793	10,704	5,544	5,371	930	840
Minority interest in consolidated subsidiaries	11,898	4,957	8,714	2,396	(110)	131	33
Total stockholders' equity	36,042	29,267	31,785	25,310	2,509	3,253	1,682

Executive Offices

Our executive offices are located in Beijing, Hong Kong, , Shenzhen and, Guangzhou, China at the following addresses:

PacificNet Beijing Office: 23/F, Building A, TimeCourt, No.6 Shuguang Xili, Chaoyang District, Beijing, China Postal Code: 100028. Tel:86-010-59225020, Fax: 86-010-59225001 and Email: BJ-Office@PacificNet.com.

PacificNet Limited Hong Kong Office: 601 New Bright Building, 11 Sheung Yuet Road, Kowloon Bay, Kowloon, Hong Kong. Tel: 011-852-2876-2900, Fax: 011-852-27930689 and E-mail: HKOffice@PacificNet.com

PacificNet Shenzhen Office: Room 901, Tower A, Tian An High-Tech Plaza, Tian An Cyber Park, Fu Tian District, Shenzhen, China Postal Code: 518040. Tel:011-86-7553360672, Fax: 011-86-7553360675 and Email: SZ-Office@PacificNet.com.

PacificNet Guangzhou Office: 15/F, Building A, Huajian Plaza, No. 233 Tianfu Road, Tianhe District, Guangzhou, China Postal Code: 510630. Tel: 011-86-020-85613432, Fax: 011-86-020-81613659 and Email: GZ-Office@PacificNet.com.

RISK FACTORS

Investing in our securities involves a great deal of risk. Careful consideration should be made of the following factors as well as other information included in this prospectus before deciding to purchase our common stock. You should pay particular attention to the fact that we conduct a majority of our operations in China and are governed by a legal and regulatory environment that in some respects differs significantly from the environment that may prevail in other countries. Our business, financial condition or results of operations could be affected materially and adversely by any or all of these risks.

THE FOLLOWING MATTERS MAY HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS, FINANCIAL CONDITION, LIQUIDITY, RESULTS OF OPERATIONS OR PROSPECTS, FINANCIAL OR OTHERWISE. REFERENCE TO THIS CAUTIONARY STATEMENT IN THE CONTEXT OF A FORWARD-LOOKING STATEMENT OR STATEMENTS SHALL BE DEEMED TO BE A STATEMENT THAT ANY ONE OR MORE OF THE FOLLOWING FACTORS MAY CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE IN SUCH FORWARD-LOOKING STATEMENT OR STATEMENTS.

RISKS RELATED TO OUR BUSINESS

WE HAVE A LIMITED OPERATING HISTORY AND RECENTLY EXPERIENCED A SIGNIFICANT INCREASE IN REVENUE THAT MAY NOT BE SUSTAINED.

Our business operations commenced in 1994, and subsequently the business was incorporated as a Delaware corporate entity in 1999. Our operating history may be insufficient to evaluate our business and future prospects. Although our revenue have grown rapidly in the past two years, primarily as a result of our increased acquisition activity, we cannot assure investors that we will maintain our profitability or that we will not incur net losses in the future. We expect that our operating expenses will increase as we expand. Any significant failure to realize anticipated revenue growth could result in significant operating losses. We will continue to encounter risks and difficulties in implementing our business model, including our potential failure to:

- increase awareness of our brands, protect our reputation and develop customer loyalty;
- manage our expanding operations and service offerings, including the integration of any future acquisitions;
- maintain adequate control of our expenses; and
- anticipate and adapt to changing conditions in the markets in which we operate as well as the impact of any changes in government regulation, mergers and acquisitions involving our competitors, technological developments and other significant competitive and market dynamics.

If we are not successful in addressing any or all of these risks, our business may be materially and adversely affected.

THE ACQUISITION OF NEW BUSINESSES IS COSTLY AND SUCH ACQUISITIONS MAY NOT ENHANCE OUR FINANCIAL CONDITION.

Our growth strategy is to acquire companies and identify and acquire assets and technologies from businesses in greater China that have services, products, technologies, industry specializations or geographic coverage that extend or complement our existing business. The process to undertake a potential acquisition is time-consuming and costly. We expend significant resources to undertake business, financial and legal due diligence on our potential acquisition target and there is no guarantee that we will acquire the company after completing due diligence. Any future acquisitions will be subject to a number of challenges, including:

- the diversion of management time and resources and the potential disruption of our ongoing business;
- difficulties in maintaining uniform standards, controls, procedures and policies;
- potential unknown liabilities associated with acquired businesses;
- the difficulty of retaining key alliances on attractive terms with partners and suppliers; and
- the difficulty of retaining and recruiting key personnel and maintaining employee morale.

Our acquisitions could result in the use of substantial amounts of cash, potentially dilutive issuances of equity securities and exposure to undisclosed or potential liabilities of acquired companies. During the fiscal year ended December 31, 2005, we acquired a controlling interest in Guangzhou 3G Information Technology Co. Ltd. (“Guangzhou3G-WOFE”), Guangzhou Clickcom Digit-net Science and Technology Ltd. (“Clickcom-WOFE”) and Shenzhen GuHaiGuanChao Investment Consultant Company Limited (“ChinaGoHi”), a wholly owned foreign enterprise (WOFE) registered in China. We expect that acquisitions will strengthen our position as a provider of outsourced call center, VAS and communication products in Asia. Although our agreements provide that the consideration is payable upon the acquired company attaining certain income milestones annually, there is no guarantee that these milestones will be reached. If they are not reached as anticipated, the time, cost and capital to acquire the company may outweigh the anticipated benefits from consolidation of their income. PacificNet recorded approximately $8.88 million of goodwill as a result of several acquisitions that is not subject to amortization in the ordinary course of business. To the extent that the businesses acquired in these transactions do not remain competitive, some or all of the goodwill related to that acquisition could be charged against future earnings.

A SUBSTANTIAL PORTION OF OUR BUSINESS DEPENDS ON MOBILE TELECOMMUNICATIONS OPERATORS IN CHINA AND ANY LOSS OR DETERIORATION OF SUCH RELATIONSHIPS MAY RESULT IN SEVERE DISRUPTIONS TO OUR BUSINESS OPERATIONS.

We rely entirely on the networks and gateways of China Mobile and China Unicom to provide our wireless value-added services. Thus, we face certain risks in conducting our wireless value-added services business, such as the following:

(1) Currently, China Mobile and China Unicom are the only mobile telecommunications operators in China that have platforms for wireless value-added services. Our agreements with them 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 us, we will not be able to conduct our existing wireless value-added services business.

(2) Our agreements with China Mobile and China Unicom are subject to negotiation upon expiration. If any of the mobile telecommunications operators decides to change its content or transmission fees or its share of revenue, or does not comply with the terms of the agreement, our revenue and profitability could be materially adversely affected.

THE MOBILE TELECOMMUNICATIONS OPERATORS MAY LAUNCH AND MAY HAVE ALREADY LAUNCHED COMPETING SERVICES OR COULD DISCONTINUE THE USE OF EXTERNAL CONTENT AGGREGATORS SUCH AS OURSELVES ENTIRELY AT ANY TIME.

Due to our reliance on the mobile telecommunications operators for our wireless value-added services, any loss or deterioration of our relationship with any of the mobile telecommunications operators may result in severe disruptions to our VAS business operations and the loss of a significant portion of our revenue.

OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS MAY BE MATERIALLY AFFECTED BY THE CHANGES IN POLICIES OR GUIDELINES OF THE MOBILE TELECOMMUNICATIONS OPERATORS.

The mobile telecommunications operators in China may, from time to time, issue certain operating policies or guidelines, requesting or stating its preference for certain actions to be taken by all wireless value-added service providers using their platforms. Due to our reliance on the mobile telecommunications operators, a significant change in their policies or guidelines may have a material adverse effect on us. For example, some mobile telecommunications operators recently revised their billing policies to request all wireless value-added service providers to confirm the subscription status of those users who have not been active for three months. Such change in policies or guidelines may result in lower revenue or additional operating costs for us, and we cannot assure investors that our financial condition and results of operations will not be materially adversely affected by any policy or guideline change by the mobile telecommunications operators in the future.

WE MAY BE SUBJECT TO ADVERSE ACTIONS FOR ANY BREACH OR PERCEIVED BREACH BY US OF THE POLICIES OR GUIDELINES IMPOSED BY THE MOBILE TELECOMMUNICATIONS OPERATOR WITH RESPECT TO CONTENT PROVIDED ON OR LINKED THROUGH OUR WEBSITES.

The mobile telecommunications operators in China may impose policies or guidelines to govern or restrict the content provided by all wireless value-added service providers, including content developed by us or content supplied by others to us. The mobile telecommunications operators from time to time have requested wireless value-added services providers, including us, to remove objectionable content or links to or from websites with certain categories of content, including content that they may deem to be sexually explicit. We aggregate and develop content that we consider attractive to our targeted user base, and we cannot assure investors that the mobile telecommunications operators will not from time to time find certain portions of our content to be objectionable. In the case of a breach or perceived breach of such policies or guidelines, the mobile telecommunications operators may require us to reduce or curtail the content on our Internet portal, which may reduce our portal traffic, and the mobile telecommunications operators may have the right to impose monetary fines upon us, or terminate our cooperation with them. In addition, we would be liable to the mobile telecommunications operators for their economic losses pursuant to our agreements with these operators if we were found to be in breach of the policies or guidelines promulgated by them. As a result of the occurrence of any of the above, our financial condition and results of operations may be materially adversely affected.

OUR DEPENDENCE ON THE SUBSTANCE AND TIMING OF THE BILLING SYSTEMS OF THE MOBILE TELECOMMUNICATIONS OPERATORS MAY REQUIRE US TO ESTIMATE PORTIONS OF OUR REPORTED REVENUE FOR WIRELESS VALUE-ADDED SERVICES FROM TIME TO TIME. AS A RESULT, SUBSEQUENT ADJUSTMENTS MAY HAVE TO BE MADE TO OUR WIRELESS VALUE-ADDED SERVICES REVENUE IN OUR FINANCIAL STATEMENTS.

As we do not bill our wireless value-added services users directly, we depend on the billing systems and records of the mobile telecommunications operators to record the volume of our wireless value-added services provided, charge our users through mobile telephone bills and collect payments from our users and pay us. In addition, we do not generally have the ability to independently verify or challenge the accuracy of the billing systems of the mobile telecommunications operators. Generally, within 20 to 60 days after the end of each month, a statement from each of the mobile telecommunications operators confirming the value of wireless value-added services they bill to users in that month will be delivered to us, and generally within 60 days after such delivery, we will be paid by the mobile telecommunications operators for the wireless value-added services, net of their revenue share, transmission fees and applicable business taxes, for that month based on such statements.

OUR COMMUNICATION PRODUCTS ARE PROVIDED CASH-ON-DELIVERY, WHICH LEAVES US VULNERABLE TO THEFT AND EMPLOYEE EMBEZZLEMENT.

The purchase of calling cards, SIM cards and other mobile phone products are made with cash. Although there is a low risk that clients will not pay for these services when delivered, our retail stores maintain cash on hand which might make them robbery targets. We also face the risk that employees who collect the cash and others who may be aware that cash is available at these sites might embezzle the money. Theft or embezzlement could have a material adverse effect on the revenue generated and the financial condition of our business operations.

WE INTEND TO OPERATE EACH OF OUR ACQUIRED BUSINESSES ON A STANDALONE BASIS.

We do not intend to integrate the information or communications systems, management, or other aspects of the businesses we acquire. If we integrated the businesses, we might be able to reduce expenses by eliminating duplicative personnel, facilities, or technology and other costs. In addition, facilities and technology integration might make inter-company communications and transactions more efficient. By declining to integrate the acquired businesses, we might forego opportunities to operate more profitably. Furthermore, our decision not to integrate these businesses might result in difficulties in evaluating the effectiveness of our internal control over financial reporting, which could complicate compliance with Section 404 of the Sarbanes-Oxley Act of 2002.

BECAUSE WE DO NOT HAVE EMPLOYMENT AGREEMENTS WITH MANAGEMENT OF THE ACQUIRED COMPANIES, OUR BUSINESS OPERATIONS MIGHT BE INTERRUPTED IF THEY WERE TO RESIGN AND SEEK EMPLOYMENT WITH COMPETITORS.

As part of our acquisition strategy, we do not use our own employees or members of our management team to operate the acquired companies. Key management at these companies has been in place for several years and has established solid relationships with their customers. Competition in our industry for executive-level personnel is strong and we can make no assurance that we will be able to retain the highly effective executive employees. Although we provide incentives to management to stay with the acquired business, we have not entered into employment agreements with them. If such key persons were to resign we might face impairment of relationships with remaining employees or customers, which might result in further resignation by employees, and might cause long-term clients to terminate their relationship with us. Furthermore, we have not entered into any non-competition and confidentiality agreements with these employees and management. Due to the limited enforceability of these types of agreements in China, we face the risk that employees of the acquired subsidiaries might divulge our software and other protected intellectual property secrets to competitors.

OUR CUSTOMERS ARE CONCENTRATED IN A LIMITED NUMBER OF INDUSTRIES.

Our clients are concentrated primarily in the telecommunications, telemarketing and technology industries, and to a lesser extent, the insurance and financial services industries, where the current trend is to outsource certain CRM and VAS. Our ability to generate revenue depends on the demand for our services in these industries. An economic downturn, or a slowdown or reversal of the tendency in any of these industries to rely on outsourcing could have a material adverse effect on our business, results of operations or financial condition.

THE MARKET IN WHICH WE COMPETE IS HIGHLY COMPETITIVE AND FRAGMENTED AND WE MAY NOT BE ABLE TO MAINTAIN MARKET SHARE.

We expect competition to persist and intensify in the future. Our competitors are mainly leaders in the CRM services market, such as PCCW Teleservices (Hong Kong) Limited, China Motion Telecom International Limited, and Teletech (Hong Kong) Limited. Our competitors also include small firms offering specific applications, divisions of large entities and other large independent firms. We face the risk that new competitors with greater resources than ours will enter our market. Furthermore, increasing competition among telecom companies in greater China has led to a reduction in telecommunication services fees that can be charged by such companies. If a reduction in telecommunication services fees negatively impacts revenue generated by our clients, they may require us to reduce the price of our services, or seek competitors of ours that charge less. If we must significantly reduce the price of our services, the decrease in revenue could adversely affect our profitability.

KEY EMPLOYEES ARE ESSENTIAL TO GROWING OUR BUSINESS.

Tony Tong, our Chairman and Chief Executive Officer, and Victor Tong, our President, are essential to our ability to continue to grow through acquisitions. Messrs. Tong and Tong have established relationships within our industry. Their business contacts have been critical in identifying and negotiating with acquisition candidates. If either of them were to leave our employ, our growth strategy might be hindered, which could limit our ability to increase revenue.

THE ESTABLISHMENT AND EXPANSION OF INTERNATIONAL OPERATIONS REQUIRES SIGNIFICANT MANAGEMENT ATTENTION.

All of our current, as well as any anticipated future revenue, are or are expected to be derived from Asia. Our international operations are subject to risks, including the following, which, if not planned and managed properly, could materially adversely affect our business, financial condition and operating results:

- legal uncertainties or unanticipated changes regarding regulatory requirements, liability, export and import restrictions, tariffs and other trade barriers;
- longer customer payment cycles and greater difficulties in collecting accounts receivable;
- uncertainties of laws and enforcement relating to the protection of intellectual property; and
- potentially uncertain or adverse tax consequences.

OUR OPERATIONS COULD BE CURTAILED IF WE ARE UNABLE TO OBTAIN REQUIRED ADDITIONAL FINANCING.

Since inception our investments and operations primarily have been financed through sales of our common stock. In the first quarter of 2006 we completed a financing of convertible debentures for $8,000,000. In the future we may need to raise additional funds through public or private financing, which may include the sale of equity securities, including securities convertible into our common stock. The issuance of these equity securities could result in dilution to our stockholders. If we are unable to raise capital when needed, our business growth strategy may slow, which could severely limit our ability to increase revenue.

FLUCTUATIONS IN THE VALUE OF THE HONG KONG DOLLAR OR RMB RELATIVE TO FOREIGN CURRENCIES COULD AFFECT OUR OPERATING RESULTS.

We have historically conducted transactions with customers outside the United States in United States dollars. Payroll and other costs of foreign operations are payable in foreign currencies, primarily Hong Kong dollars and Chinese renminbi. To the extent future revenue is denominated in foreign currencies, we would be subject to increased risks relating to foreign currency exchange rate fluctuations that could have a material adverse affect on our business, financial condition and operating results. The value of Hong Kong dollars and Chinese renminbi against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in the PRC's political and economic conditions. As our operations are primarily in Asia, any significant revaluation of Hong Kong dollars or the Chinese renminbi may materially and adversely affect our cash flows, revenue and financial condition. For example, to the extent that we need to convert U.S. dollars into Hong Kong dollars or Chinese renminbi for our operations, appreciation of either currency against the U.S. dollar could have a material adverse effect on our business, financial condition and results of operations. Conversely, if we decide to convert our Hong Kong dollars or Chinese renminbi into U.S. dollars for other business purposes and the U.S. dollar appreciates against either currency, the U.S. dollar equivalent of the respective currency we convert would be reduced. To date, we have not engaged in any hedging transactions in connection with our international operations.

WE HAVE NEVER PAID CASH DIVIDENDS AND ARE NOT LIKELY TO DO SO IN THE FORESEEABLE FUTURE.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for use in the operation and expansion of our business. We do not expect to pay any cash dividends in the foreseeable future but will review this policy as circumstances dictate.

RISKS ASSOCIATED WITH DOING BUSINESS IN GREATER CHINA

There are substantial risks associated with doing business in greater China, as set forth in the following risk factors.

OUR OPERATIONS AND ASSETS IN GREATER CHINA ARE SUBJECT TO SIGNIFICANT POLITICAL AND ECONOMIC UNCERTAINTIES.

Changes in laws and regulations, or their interpretation, or the imposition of confiscatory taxation, restrictions on currency conversion, imports and sources of supply, 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. Under its current leadership, the Chinese government has been pursuing economic reform policies that encourage private economic activity and greater economic decentralization. There is no assurance, however, that the Chinese government will continue to pursue these policies, or that it will not significantly alter these policies from time to time without notice.

CURRENCY FLUCTUATIONS AND RESTRICTIONS ON CURRENCY EXCHANGE MAY ADVERSELY AFFECT OUR BUSINESS, INCLUDING LIMITING OUR ABILITY TO CONVERT CHINESE RENMINBI INTO FOREIGN CURRENCIES AND, IF CHINESE RENMINBI WERE TO DECLINE IN VALUE, REDUCING OUR REVENUE IN U.S. DOLLAR TERMS.

Our reporting currency is the U.S. dollar and our operations in China and Hong Kong use their respective local currencies as their functional currencies. The majority of our revenue derived and expenses incurred are in Chinese renminbi with a relatively small amount in Hong Kong dollars and U.S. dollars. We are subject to the effects of exchange rate fluctuations with respect to any of these currencies. For example, the value of the renminbi depends to a large extent on Chinese government policies and China’s domestic and international economic and political developments, as well as supply and demand in the local market. Since 1994, the official exchange rate for the conversion of renminbi to U.S. dollars had generally been stable and the renminbi had appreciated slightly against the U.S. dollar. However, on July 21, 2005, the Chinese government changed its policy of pegging the value of Chinese renminbi to the U.S. dollar. Under the new policy, Chinese renminbi may fluctuate within a narrow and managed band against a basket of certain foreign currencies. As a result of this policy change, Chinese renminbi appreciated approximately 2.5% against the U.S. dollar in 2005. It is possible that the Chinese government could adopt a more flexible currency policy, which could result in more significant fluctuation of Chinese renminbi against the U.S. dollar. We can offer no assurance that Chinese renminbi will be stable against the U.S. dollar or any other foreign currency.

The income statements of our international operations are translated into U.S. dollars at the average exchange rates in each applicable period. To the extent the U.S. dollar strengthens against foreign currencies, the translation of these foreign currencies denominated transactions results in reduced revenue, operating expenses and net income for our international operations. Similarly, to the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency denominated transactions results in increased revenue, operating expenses and net income for our international operations. We are also exposed to foreign exchange rate fluctuations as we convert the financial statements of our foreign subsidiaries into U.S. dollars in consolidation. If there is a change in foreign currency exchange rates, the conversion of the foreign subsidiaries’ financial statements into U.S. dollars will lead to a translation gain or loss which is recorded as a component of other comprehensive income. In addition, we have certain assets and liabilities that are denominated in currencies other than the relevant entity's functional currency. Changes in the functional currency value of these assets and liabilities create fluctuations that will lead to a transaction gain or loss. We have not entered into agreements or purchased instruments to hedge our exchange rate risks, although we may do so in the future. The availability and effectiveness of any hedging transaction may be limited and we may not be able to successfully hedge our exchange rate risks.

Although Chinese governmental policies were introduced in 1996 to allow the convertibility of Chinese renminbi into foreign currency for current account items, conversion of Chinese renminbi into foreign exchange for capital items, such as foreign direct investment, loans or securities, requires the approval of the State Administration of Foreign Exchange, or SAFE, which is under the authority of the People's Bank of China. These approvals, however, do not guarantee the availability of foreign currency. We cannot be sure that we will be able to obtain all required conversion approvals for our operations or that Chinese regulatory authorities will not impose greater restrictions on the convertibility of Chinese renminbi in the future. Because a significant amount of our future revenue may be in the form of Chinese renminbi, our inability to obtain the requisite approvals or any future restrictions on currency exchanges could limit our ability to utilize revenue generated in Chinese renminbi to fund our business activities outside China, or to repay foreign currency obligations, including our debt obligations, which would have a material adverse effect on our financial condition and results of operation.

WE ARE REQUIRED TO OBTAIN LICENSES TO EXPAND OUR BUSINESS INTO MAINLAND CHINA.

Our activities must be reviewed and approved by various national and local agencies of the Chinese government before they will issue business licenses to us. There can be no assurance that the current Chinese government, or successors, will continue to approve and renew our licenses. If we are unable to obtain licenses or renewals we will not be able to continue our business operations in mainland China, which would have a material adverse effect on our business, financial condition and results of operations.

WE MAY HAVE LIMITED LEGAL RECOURSE UNDER PRC LAW IF DISPUTES ARISE UNDER OUR CONTRACTS WITH THIRD PARTIES.

The Chinese government has enacted some laws and regulations dealing with matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, their experience in implementing, interpreting and enforcing these laws and regulations is limited, and our ability to enforce commercial claims or to resolve commercial disputes is unpredictable. If our new business ventures are unsuccessful, or other adverse circumstances arise from these transactions, we face the risk that the parties to these ventures may seek ways to terminate the transactions, or, may hinder or prevent us from accessing important information regarding the financial and business operations of these acquired companies. The resolution of these matters may be subject to the exercise of considerable discretion by agencies of the Chinese government, and forces unrelated to the legal merits of a particular matter or dispute may influence their determination. Any rights we may have to specific performance, or to seek an injunction under PRC law, in either of these cases, are severely limited, and without a means of recourse by virtue of the Chinese legal system, we may be unable to prevent these situations from occurring. The occurrence of any such events could have a material adverse effect on our business, financial condition and results of operations.

WE MUST COMPLY WITH THE FOREIGN CORRUPT PRACTICES ACT.

We are required to comply with the United States Foreign Corrupt Practices Act, which prohibits United States companies from engaging in bribery or other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Foreign companies, including some of our competitors, are not subject to these prohibitions. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices occur from time-to-time in mainland China. If our competitors engage in these practices they may receive preferential treatment from personnel of some companies, giving our competitors an advantage in securing business or from government officials who might give them priority in obtaining new licenses, which would put us at a disadvantage. Although we inform our personnel that such practices are illegal, we can not assure that our employees or other agents will not engage in such conduct for which we might be held responsible. If our employees or other agents are found to have engaged in such practices, we could suffer severe penalties.

PRC LAWS AND REGULATIONS RESTRICT FOREIGN INVESTMENT IN CHINA'S TELECOMMUNICATIONS SERVICES INDUSTRY AND SUBSTANTIAL UNCERTAINTIES EXIST WITH RESPECT TO OUR CONTRACTUAL AGREEMENTS WITH DIANXUN-DE, SUNROOM-DE, WANRONG-DE AND IMOBILE-DE TO UNCERTAINTIES REGARDING THE INTERPRETATION AND APPLICATION OF CURRENT OR FUTURE PRC LAWS AND REGULATIONS.

Since we are deemed to be foreign persons or foreign funded enterprises under PRC laws and cannot directly invest in telecommunications companies, we operate our IVR, call center and telecom value-added services business in China through operating companies or variable interest entities (VIEs) owned by PRC citizens. We control these companies and operate these businesses through contractual arrangements with the respective operating companies and their individual shareholders, but we have no equity control over these companies. Although we believe we are in compliance with current PRC regulations, we cannot be sure that the PRC government would view these operating arrangements to be in compliance with PRC licensing, registration or other regulatory requirements, with existing policies or with requirements or policies that may be adopted in the future. In the opinion of our in-house PRC legal counsel, our current ownership structure, the contractual arrangements among our wholly owned subsidiaries and the operating company and their shareholders comply with all existing applicable PRC laws, rules and regulations. Because this structure has not been challenged or examined by PRC authorities, they have not commented on it and uncertainties exist as to whether the PRC government may interpret or apply the laws governing these arrangements in a way that is contrary to the opinion of our in-house PRC counsel. If we, or the operating companies, were found to be in violation of any existing PRC laws or regulations, the relevant regulatory authorities would have broad discretion to deal with such violation, including, but not limited to the following:

- levying fines;
- confiscating income;
- revoking licenses;
- shutting down servers or blocking websites;
- requiring a restructure of ownership or operations; and/or
- requiring the discontinuance of wireless VAS and online advertising businesses.

We may also encounter difficulties in obtaining performance under or enforcement of related contracts. Any of these or similar actions could cause significant disruption to our business operations or render us unable to conduct a substantial portion of our business operations and may materially adversely affect our business, financial condition and results of operations.

OUR CONTRACTUAL AGREEMENTS WITH DIANXUN-DE, SUNROOM-DE, WANRONG-DE AND IMOBILE-DE MAY NOT BE AS EFFECTIVE IN PROVIDING OPERATIONAL CONTROL AS DIRECT OWNERSHIP OF THESE BUSINESSES.

We depend on operating companies in which we have little or no equity ownership interest and must rely on contractual agreements to control and operate these businesses. Our contractual agreements with each of the operating companies may not be as effective in providing and maintaining control over the operating companies and their business operations as direct ownership of these businesses. For example, we may not be able to take control of the operating company upon the occurrence of certain events, such as the imposition of statutory liens, judgments, court orders, death or capacity. Furthermore, if the operating companies fail to perform as required under those contractual agreements, we will have to rely on the PRC legal system to enforce those agreements and due to the uncertainties that exist under PRC Law about the structure of our acquisition, and there is no guarantee that we will be successful in an enforcement action. In addition, the PRC government may propose new laws or amend current laws that may be detrimental to our current contractual agreements with our operating companies, which may in turn have a material adverse effect on our business operations.

THE PRC GOVERNMENT MAY PREVENT US FROM ADVERTISING OR DISTRIBUTING CONTENT THAT IT BELIEVES IS INAPPROPRIATE

China has enacted regulations governing Internet access and the distribution of news and other information. In the past, the Chinese government has stopped the distribution of information over the Internet or through VAS that it believes to violate PRC law, including content that it believes is obscene, incites violence, endangers national security, is contrary to the national interest or is defamatory. In addition, we may need the permission of the Chinese government prior to publishing certain news items, such as news relating to national security. Furthermore, the Ministry of Public Security has the authority to cause any local Internet service provider to block any website maintained outside China at its sole discretion. If the PRC government were to take any action to limit or prohibit the distribution of information through our network or via our VAS, or to limit or regulate any current or future content or services available to users on our network, our business could be significantly harmed. We are also subject to potential liability for content on our website that is deemed inappropriate and for any unlawful actions of our subscribers and other users of our systems. Furthermore, we are required to delete content that clearly violates the laws of China and report content that we suspect may violate PRC law. It is difficult to determine the type of content that may result in liability for us, and if we are wrong, we may be prevented from operating our website.

POTENTIAL VIOLATION OF THE PRC REGULATION DUE TO INSUFFICIENT REGISTERED CAPITAL OF VIE

Through GuangZhou DianXun Company Limited (the "Dianxun-DE"), a Chinese variable interest entity ('VIE') controlled through business agreement, we are 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 registered capital of Dianxun-DE was approx. US$1.25million, 90% of which was funded by borrowed assets at the inception of the company in order to obtain the operating license for the regulated VAS industry in which the VIE operates. The borrowed assets were returned to lenders subsequent to obtaining the necessary regulatory approval for the registered capital. On consolidation of this VIE for the year ended December 31, 2005, we reduced the registered capital of the VIE to $125,000 to reflect the fair value of its net asset value at the time of acquisition. We will not be able to continue our business operations through this VIE if the regulatory authorities do not renew the licenses due to insufficient registered capital. For indicative purposes according to the PRC Telecommunication Rules, all telecommunication value added service providers can only carry on business if a Company maintains a minimum capital requirement of at least RMB10,000,000. The minimum capital requirement required in Shanghai, China, in order to get a provincial VAS license is Rmb1,000,000 (or US$125,000).

RISKS RELATED TO OUR TECHNOLOGY AND EQUIPMENT

OUR INSURANCE MAY NOT BE SUFFICIENT TO RESTORE OUR CALL CENTER IF OPERATIONS ARE INTERRUPTED BY NATURAL DISASTER OR OTHER DESTRUCTION OF OUR FACILITIES OR EQUIPMENT.

Our operations depend on our ability to protect our call centers, data centers, CRM information, customer database, data warehouse, computer and telecommunications equipment and software systems against damage from fire, power loss, telecommunications interruption or failure, hacker attacks, natural disaster, epidemic, terrorism, act of war and other similar events. In the event we experience a temporary or permanent interruption at one or more of our call centers, through casualty, operating malfunction or otherwise, our business could be materially adversely affected and we may be required to pay contractual damages to some clients or allow some clients to terminate or renegotiate their contracts with us. While we maintain certain property and business interruption insurance, such insurance may not adequately compensate us for all losses that we may incur and may not be adequate to cover the costs of rebuilding these centers. If we are unable to restore our operations, our business activities would cease.

WE MUST RESPOND QUICKLY AND EFFECTIVELY TO NEW TECHNOLOGICAL DEVELOPMENTS.

Our VAS business is highly dependent on our computer and telecommunications equipment and software systems. Our failure to maintain the superiority of our technological capabilities or to respond effectively to technological changes could adversely affect our business, results of operations or financial condition. Our future success also depends on our ability to enhance existing software and systems and to respond to changing technological developments. If we are unable to successfully develop and bring to market new software and systems in a timely manner, our competitors technologies or services may render our products or services noncompetitive or obsolete.

RISKS RELATED TO OUR COMMON STOCK

EFFORTS TO COMPLY WITH RECENTLY ENACTED CHANGES IN SECURITIES LAWS AND REGULATIONS WILL INCREASE OUR COSTS AND REQUIRE ADDITIONAL MANAGEMENT RESOURCES. OUR FAILURE TO COMPLY COULD ADVERSELY AFFECT OUR STOCK PRICE.

We have rapidly grown by acquisition during 2004 and 2005. We do not integrate the business operations of our target companies and therefore have separate administration and accounting personnel at each subsidiary location. We have sought to improve our existing disclosure controls and procedures and to that end, have substantially increased our accounting and administrative resources. Due to the number of new subsidiaries we have acquired, we have faced significant challenges with the timely reporting of information necessary to complete the financial statements to be filed with the Securities and Exchange Commission. Our failure to timely file our annual and quarterly reports may have an adverse affect on our stock price and may put our common stock in jeopardy of being delisted.

As directed by Section 404 of the Sarbanes-Oxley Act of 2002, public companies are required to include a report of management on the company’s internal controls over financial reporting in their annual reports on Form 10-K and the public accounting firm auditing a company’s financial statements must attest to and report on management’s assessment of the effectiveness of the company’s internal controls over financial reporting. This requirement will first apply to our annual report on Form 10-K for our fiscal year ending December 31, 2007. We have only recently begun to evaluate our internal controls over financial reporting. Given the status of our efforts, coupled with the fact that guidance from regulatory authorities in the area of internal controls continues to evolve, substantial uncertainty exists regarding our ability to comply by applicable deadlines. If we are unable to conclude that we have effective internal controls over financial reporting, or if our independent auditors are unable to provide us with an unqualified report as to the effectiveness of our internal controls over financial reporting as of December 31, 2007 and future year ends, as required by Section 404 of the Sarbanes-Oxley Act, we could experience delays or inaccuracies in our reporting of financial information, or non-compliance with SEC reporting and other regulatory requirements. This could subject us to regulatory scrutiny and result in a loss of public confidence in our management, which could, among other things, adversely affect our stock price.

WE ISSUED $8,000,000 IN CONVERTIBLE DEBENTURES DUE IN 2009, OR POSSIBLY EARLIER, WHICH WE MAY NOT BE ABLE TO REPAY IN CASH AND COULD RESULT IN DILUTION OF OUR BASIC EARNINGS PER SHARE.

In March 2006, we issued $8 million in convertible debentures due March 2009. The debentures are convertible at any time into shares of our common stock at an initial fixed conversion price of $10.00 per share, subject to adjustments for certain events. If any event of default occurs under the debentures or other related documents (including, but not limited to the payment of liquidated damages under the terms of the registration rights agreement, which as of the date of this prospectus, has not been paid), the holders may elect to accelerate the payment of the outstanding principal amount of the debenture, plus accrued, but unpaid interest, liquidated damages or other amounts, which shall become immediately due and payable. Beginning January 1, 2007, we are obligated to redeem $320,000 every month, plus accrued, but unpaid interest, liquidated damages and penalties. We may choose to pay such redemption amount in cash, or, subject to meeting certain conditions, we may pay all or a part of the redemption amount in shares of common stock. We may not have enough cash on hand or have the ability to access cash to pay the redemption amount, or upon acceleration of the debenture in the case of an event of default, or at maturity. In addition, the redemption of the debentures with our shares or the conversion of the debentures into shares of common stock could result in dilution of our basic earnings per share.

THE PRICE OF OUR STOCK HAS FLUCTUATED IN THE PAST AND MAY CONTINUE TO DO SO.

Our stock price has fluctuated dramatically. There is a significant risk that the market price of our common stock will decrease in the future in response to any of the following factors, some of which are beyond our control:

- variations in our quarterly operating results;
- announcements that our revenue or income are below analysts' expectations;
- general economic slowdowns;
- changes in market valuations of similar companies;
- sales of large blocks of our common stock;
- announcements by us or our competitors of significant contracts, acquisitions, strategic partnerships, joint ventures or capital commitments; and
- fluctuations in stock market prices and volumes, which are particularly common among highly volatile securities of companies with primarily international-based operations.

FUTURE SALES OF SHARES COULD HAVE AN ADVERSE EFFECT ON THE MARKET PRICE OF OUR COMMON STOCK

As of October 31, 2006, we had 14,008,497 shares of common stock issued, of which 11,671,836 shares were outstanding, which shares will be available to be sold in the public market in the near future, subject to, with respect to shares of common stock held by affiliates and shares issued between 12 and 24 months ago, the volume restrictions and/or manner of sale requirements of Rule 144 under the Securities Act. On February 4, 2005, a registration statement on Form SB-2 was declared effective with respect to 2,702,230 shares of our common stock. These shares are freely tradable without restriction or further registration, subject to the related prospectus delivery requirements. Sales by our current shareholders of a substantial number of shares could significantly reduce the market price of our common stock.

As of September 30, 2006, we had stock options outstanding to purchase an aggregate of 1,026,000 shares of common stock, of which 526,000 stock options were exercisable and warrants outstanding to purchase 1,026,000 shares of our common stock. To the extent that the options and warrants are exercised, they may be exercised at prices below the price of our shares of common stock on the public market, resulting in a significant number of shares entering the public market and the dilution of our common stock. Further, in March 2006, we completed a private placement of $8,000,000 in convertible debentures. The debentures are convertible into shares of common stock at an initial fixed conversion price of $10.00, subject to adjustments. In the event that any future financing should also be in the form of securities convertible into, or exchangeable for, equity securities, investors may experience additional dilution upon the conversion or exchange of such securities.

USE OF PROCEEDS

This prospectus relates to shares of our common stock that may be offered and sold from time to time by certain selling stockholders. There will be no proceeds to us from the sale of shares of common stock in this offering. Assuming that all of the warrants held by selling stockholders are exercised for cash, we will realize proceeds of approximately $10,606,647. We would use these funds for general corporate purposes.

SELLING STOCKHOLDERS

We are registering for resale shares of our common stock (i) held by the selling stockholders identified below and (ii) issuable to the selling security holders upon the conversion of outstanding debentures or exercise of outstanding warrants, or that may be issued in the form of interest payments on such debentures. We are registering the shares to permit the securityholders and their pledgees, donees, transferees and other successors-in-interest that receive their shares from a stockholder as a gift, partnership distribution or other non-sale related transfer after the date of this prospectus to resell the shares when and as they deem appropriate.

The following table set forth:

- the name of the securityholders,
- the number and percent of shares of our common stock that the securityholders beneficially owned prior to the offering for resale of the shares under this prospectus,
- the number of shares of our common stock that may be offered for resale for the account of the securityholders under this prospectus, and
- the number and percent of shares of our common stock to be beneficially owned by the security holders after the offering of the resale shares (assuming all of the offered resale shares are sold by the securityholders).

The number of shares in the column “Maximum Number of Shares to be Sold” represents all of the shares that each security holder may offer under this prospectus. We do not know how long the security holders will hold the shares before selling them or how many shares they will sell, and we currently have no agreements, arrangements or understandings with any of the security holders regarding the sale of any of the resale shares. The shares offered by this prospectus may be offered from time to time by the securityholders listed below.

This table is prepared solely based on information supplied to us by the listed securityholders, any Schedules 13D or 13G and Forms 3 and 4, and other public documents they have filed with the SEC, and assumes the sale of all of the shares offered hereby. The applicable percentages of beneficial ownership are based on an aggregate of 11,671,836 shares of our common stock issued and outstanding on November 1, 2006 or subject to issuance upon exercise of the warrants, adjusted as may be required by rules promulgated by the SEC.

On March 13, 2006, we completed a private placement in which we sold $8,000,000 in convertible debentures, convertible into shares of common stock at an initial fixed conversion price of $10.000, subject to adjustment, and issued warrants to purchase up to an aggregate of 416,000 shares of common stock. Under the terms of the registration rights agreement, we are required to register 150% of the maximum number of shares of our common stock issuable upon (i) conversion of the convertible debentures, (ii) exercise of the warrants and (iii) the payment of interest assuming the debentures remain outstanding for three years. Accordingly we have registered for resale an additional 660,000 shares. The number of shares included below in the columns entitled “Shares Beneficially Owned Prior to the Offering” and the “Maximum Number of Shares to be Sold” do not include the 104,000 interest shares issuable if the Company elects to issue such shares in lieu of cash and the additional 660,000 shares as these share amounts are not beneficially owned by the selling stockholders who participated in the March 2006 private placement. The 104,000 interest shares and 660,000 additional shares if issued, will be allocated to the investors from the convertible debenture financing on a pro rata basis.

On June 8, 2005, we entered into a consulting agreement with CEOCast, Inc., our current investor relations and public relations firm. Pursuant to the terms of the agreement, part of the compensation to CEOCast consisted of the issuance of 26,000 shares of our common stock. We granted CEOCast piggyback registration rights with respect to those shares.

1,152,228 of the shares being offered by certain of the selling shareholders set forth below were previously registered on a Registration Statement of Form SB-2 (Registration No. 333-121792), that was declared effective on February 4, 2005.

No selling stockholder listed below has held any position nor had any material relationship with the us or our affiliates during the past three years, except that C.E. Unterberg, Towbin LLC acted as placement agent in the convertible debenture financing consummated in March 2006. C.E. Unterberg, Towbin Capital Partners I, L.P. is an entity associated with C.E. Unterberg, Towbin LLC. CEOCast is our investor and public relations firm.

Name of Selling Stockholder	Shares Beneficially Owned Prior to Offering	Maximum Number of Shares to be Sold	Number of Shares Beneficially Owned After Offering	Percentage Ownership After Offering
SF Capital Partners Ltd.(1)	135,000	135,000	0	0
Bluegrass Growth Fund LP(2)	11,667	11,667	0	0
Bluegrass Growth Fund Ltd.(3)	11,667	11,667	0	0
Omicron Master Fund(4)	33,515	33,515	0	0
Iroquois Capital LP(5)	566,667	566,667	0	0
Smithfield Fiduciary LLC(6)	23,333	23,333	0	0
Portside Growth and Opportunity Fund(7)	23,333	23,333	0	0
Satellite Strategic Finance Associates, LLC(8)	105,000	105,000	0	0
CEOCast, Inc.	20,000	20,000	0	0
Sino Strategic Investment Limited (9)	385,848	385,848	0	0
Sunshine Ocean Investment Limited (10)	192,924	192,924	0	0
C.E. Unterberg, Towbin Capital Partners I, L.P. (11)	75,000	75,000	0	0
Alpha Capital AG (12)	175,720	175,720	0	0
Whalehaven Capital Fund Limited (13)	150,000	150,000	0	0
Basso Private Opportunities Holding Fund Ltd. (14)	37,500	37,500	0	0
Basso Fund Ltd. (15)	30,000	30,000	0	0
Basso Multi-Strategy Holding Fund Ltd. (16)	82,500	82,500	0	0
DKR SoundShore Oasis Holding Fund LTd.(17)	225,000	225,000	0	0
C.E. Unterberg, Towbin LLC (18)	16,000	16,000	0	0
Whalehaven Fund Limited (19)	5,144	5,144	0	0
Rockmore Investment Master Fund Ltd. (20)	15,538	15,538	0	0
Excalibur Limited Partnership (21)	15,432	15,432	0	0
Vertical Ventures LLC (22)	25,720	25,720	0	0
Stonestreet LP (23)	25,720	25,720	0	0

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(1) Includes 35,000 shares of common stock issuable upon exercise of a warrant.

(2) Includes 11,667 shares of common stock issuable upon exercise of a warrant. Bluegrass Growth Fund Partners is the managing partner of Bluegrass Growth Fund LP. By virtue of such relationship, Bluegrass Growth Fund Partners may be deemed to have voting and dispositive power over the shares owned by Bluegrass Growth Fund LP. Bluegrass Growth Fund Partners disclaims beneficial ownership of such shares. Mr. Brian Shatz has delegated authority from the partners of Bluegrass Growth Fund Partners with respect to the shares of common stock owned by Bluegrass Growth Fund LP. As such, Mr. Shatz is deemed to have voting and dispositive power over the shares of common stock owned by Bluegrass Growth Fund LP. Mr. Shatz disclaims beneficial ownership of such shares

of our common stock and has no legal right to maintain such delegated authority..

(3) Includes 11,667 shares of common stock issuable upon exercise of a warrant. Mr. Brian Shatz is a director of Bluegrass Growth Fund, Ltd. and has delegated authority from the shareholders of Bluegrass Growth Fund, Ltd. with respect to the shares of common stock owned by Bluegrass Growth Fund, Ltd. As such, Mr. Shatz is deemed to have voting and dispositive power over the shares of common stock owned by Bluegrass Growth Fund, Ltd. Mr. Shatz disclaims beneficial ownership of such shares of our common stock and has no legal right to maintain such delegated authority.

(4) Includes 33,515 shares of common stock issuable upon exercise of a warrant.

(5) Includes (i) 300,000 shares of common stock issuable upon conversion of the convertible debenture; (ii) 266,667 shares of common stock issuable upon exercise of warrants.

(6) Includes 23,333 shares of common stock issuable upon exercise of a warrant. . Highbridge Capital Management, LLC is the trading manager of Smithfield Fiduciary LLC and has voting control and investment discretion over the securities held by Smithfield Fiduciary LLC. Glenn Dubin and Henry Swieca control Highbridge Capital Management, LLC and have voting control and investment discretion over the securties held by Smithfield Fiduciary LLC. Each of Highbridge Capital Management, LLC, Glenn Dubin and Henry Swieca disclaims beneficial ownership of the securities held by Smithfield Fiduciary LLC.

(7) Includes 23,333 shares of common stock issuable upon exercise of a warrant. Ramius Capital Group, L.L.C ("Ramius Capital") is the investment adviser of Portside Growth and Opportunity Fund ("Portside") and consequently has voting control and investment discretion over securities held by Portside. Ramius Capital disclaims beneficial ownership of the shares held by Portside. Peter A. Cohen, Morgan B. Stark, Thomas W. Strauss and Jeffrey M. Solomon are the sole managing members of C4S & Co., L.L.C., the sole managing member of Ramius Capital. As a result, Messrs. Cohen, Stark, Strauus and Solomon may be considered beneficial owners of any shares deemed to be beneficially owned by Ramius Capital. Messrs. Cohen, Stark, Strauss and Solomon disclaim beneficial ownership of these shares.

(8) Includes 105,000 shares of common stock issuable upon exercise of a warrant.

(9) Includes 64,308 shares of common stock issuable upon exercise of a warrant.

(10) Includes 32,154 shares of common stock issuable upon exercise of a warrant.

(11) Includes 50,000 shares of common stock issuable upon conversion of the convertible debenture and 25,000 shares of common stock issuable upon exercise of a warrant.

(12) Includes 100,000 shares of common stock issuable upon conversion of the convertible debenture and 75,720 shares of common stock issuable upon exercise of a warrant.

(13) Includes 100,000 shares of common stock issuable upon conversion of the convertible debenture and 50,000 shares of common stock issuable upon exercise of a warrant.

(14) Includes 25,000 shares of common stock issuable upon conversion of the convertible debenture and 12,500 shares of common stock issuable upon exercise of a warrant.

(15) Includes 20,000 shares of common stock issuable upon conversion of the convertible debenture and 10,000 shares of common stock issuable upon exercise of a warrant.

(16) Includes 55,000 shares of common stock issuable upon conversion of the convertible debenture and 27,500 shares of common stock issuable upon exercise of a warrant.

(17) Includes 150,000 shares of common stock issuable upon conversion of the convertible debenture and 75,000 shares of common stock issuable upon exercise of a warrant. The investment manager of DKR SoundShore Oasis Holding Fund Ltd. (the "Fund") is DKR Oasis Management Company LP (the "Investment Manager"). The Investment Manager has the authority to do any and all acts on behalf of the Fund, including voting any shares held by the Fund. Mr. Seth Fischer is the managing partner of Oasis Management Holdings LLC, one of the general partners of the Investment Manager. Mr. Fischer has ultimate responsibility for trading with respect to the Fund. Mr. Fischer disclaims beneficial ownership of the shares.

(18) Includes shares of common stock issuable upon exercise of warrants.

(19) Includes shares of common stock issuable upon exercise of warrants.

(20) Includes shares of common stock issuable upon exercise of warrants.

(21) Includes shares of common stock issuable upon exercise of warrants.

(22) Includes shares of common stock issuable upon exercise of warrants.

(23) Includes shares of common stock issuable upon exercise of warrants.

PLAN OF DISTRIBUTION

Each Selling Stockholder (the "Selling Stockholders") of the common stock and any of their pledgees, assignees and successors-in-interest may, from time to time, sell any or all of their shares of common stock on the Nasdaq National Market or any other stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales may be at fixed or negotiated prices. A Selling Stockholder may use any one or more of the following methods when selling shares:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resale by the broker-dealer for its account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;
- settlement of short sales entered into after the effective date of the registration statement of which this prospectus is a part;
- broker-dealers may agree with the Selling Stockholders to sell a specified number of such shares at a stipulated price per share;
- through the writing or settlement of options or other hedging transactions, whether through an options exchange or otherwise;
- a combination of any such methods of sale; or
- any other method permitted pursuant to applicable law.

The Selling Stockholders may also sell shares under Rule 144 under the Securities Act of 1933, as amended (the "Securities Act"), if available, rather than under this prospectus.

Broker-dealers engaged by the Selling Stockholders may arrange for other brokers-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the Selling Stockholders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated, but, except as set forth in a supplement to this Prospectus, in the case of an agency transaction not in excess of a customary brokerage commission in compliance with NASDR Rule 2440; and in the case of a principal transaction a markup or markdown in compliance with NASDR IM-2440.

In connection with the sale of the common stock or interests therein, the Selling Stockholders may enter into hedging transactions with broker-dealers or other financial institutions, which may in turn engage in short sales of the common stock in the course of hedging the positions they assume. The Selling Stockholders may also sell shares of the common stock short and deliver these securities to close out their short positions, or loan or pledge the common stock to broker-dealers that in turn may sell these securities. The Selling Stockholders may also enter into option or other transactions with broker-dealers or other financial institutions or the creation of one or more derivative securities which require the delivery to such broker-dealer or other financial institution of shares offered by this prospectus, which shares such broker-dealer or other financial institution may resell pursuant to this prospectus (as supplemented or amended to reflect such transaction).

The Selling Stockholders and any broker-dealers or agents that are involved in selling the shares may be deemed to be "underwriters" within the meaning of the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. Each Selling Stockholder has informed the Company that it does not have any written or oral agreement or understanding, directly or indirectly, with any person to distribute the Common Stock. In no event shall any broker-dealer receive fees, commissions and markups which, in the aggregate, would exceed eight percent (8%).

The Company is required to pay certain fees and expenses incurred by the Company incident to the registration of the shares. The Company has agreed to indemnify the Selling Stockholders against certain losses, claims, damages and liabilities, including liabilities under the Securities Act.

Because Selling Stockholders may be deemed to be "underwriters" within the meaning of the Securities Act, they will be subject to the prospectus delivery requirements of the Securities Act including Rule 172 thereunder. In addition, any securities covered by this prospectus which qualify for sale pursuant to Rule 144 under the Securities Act may be sold under Rule 144 rather than under this prospectus. There is no underwriter or coordinating broker acting in connection with the proposed sale of the resale shares by the Selling Stockholders.

We agreed to keep this prospectus effective until the earlier of (i) the date on which the shares may be resold by the Selling Stockholders without registration and without regard to any volume limitations by reason of Rule 144(k) under the Securities Act or any other rule of similar effect or (ii) all of the shares have been sold pursuant to this prospectus or Rule 144 under the Securities Act or any other rule of similar effect. The resale shares will be sold only through registered or licensed brokers or dealers if required under applicable state securities laws. In addition, in certain states, the resale shares may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

Under applicable rules and regulations under the Exchange Act, any person engaged in the distribution of the resale shares may not simultaneously engage in market making activities with respect to the common stock for the applicable restricted period, as defined in Regulation M, prior to the commencement of the distribution. In addition, the Selling Stockholders will be subject to applicable provisions of the Exchange Act and the rules and regulations thereunder, including Regulation M, which may limit the timing of purchases and sales of shares of the common stock by the Selling Stockholders or any other person. We will make copies of this prospectus available to the Selling Stockholders and have informed them of the need to deliver a copy of this prospectus to each purchaser at or prior to the time of the sale (including by compliance with Rule 172 under the Securities Act).

SELECTED FINANCIAL DATA

The selected financial data presented below summarizes certain financial data which has been derived from and should be read in conjunction with our consolidated financial statements and footnotes thereto included in the section beginning on page F-1. The information for the six months ended June 30, 2005 and 2006 was derived from our unaudited financial statements but, in the opinion of management, reflects all adjustments necessary for a fair presentation of the results of such periods. You should read this data together with our financial statements and related notes included elsewhere in this prospectus and the information under “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

	Six months ended June 30,		**Year Ended December 31,**				
	2006 (unaudited)	**2005 (unaudited)**	**2005**	**2004**	**2003**	**2002**	**2001**
	(in thousands, except per share data)						
Statement of Operations Data:							
Total revenue	34,364	21,492	$ 44,341	$ 29,709	$ 1,217	$ 2,319	$ 961
Cost of revenues	(22,960)	(17,127)	(33,439)	(24,074)	(698)	(1,787)	(803)
Operating expenses: selling, general and administrative	(8,175)	(2,399)	(6,333)	(3,698)	(1,856)	(3,176)	(4,044)
Earning/(loss) from operations	3,229	1,966	4,569	1,937	(1,337)	(2,644)	(3886)
Earnings/(loss) available to common stockholders	1,719	1,008	2,489	774	(1,281)	(2,921)	(5,005)
Basic earnings/(loss) per share	0.18	0.10	0.25	0.11	(0.24)	(0.70)	(3.10)

Diluted earnings/(loss) per share	0.16	0.10	0.23	0.09	(0.23)	(0.70)	(3.10)
Shares used in computing earnings							
Basic weighted average shares (1)	10,939,834	9,840,681	10,154,271	7,268,374	5,234,744	4,191,816	1,612,415
Diluted weighted average shares (1)	12,702,019	10,559,064	10,701,211	8,241,996	5,472,565	4,191,816	1,612,415

(1) The number of shares taking into effect a 5-for 1 reverse stock split effected in January 2003.

	Six months ended June 30,		**As of December 31,**				
	2006	**2005**	**2005**	**2004**	**2003**	**2002**	**2001**
			(in thousands)				
Balance Sheet Data:							
Cash, cash equivalents, and marketable securities (excludes restricted cash)	$ 6,474	$ 6,019	$ 10,118	$ 6,793	$ 3,823	$ 3,694	$ 1,344
Working capital	29,822	16,117	20,510	16,185	1,442	3,081	1,012
Total assets	66,457	43,017	51,203	33,250	7,770	4,314	2,555
Total stockholders' equity	36,042	29,267	31,785	25,310	2,509	3,253	1,682

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SUPPLEMENTARY FINANCIAL INFORMATION

The supplementary financial information presented below summarizes certain financial data which has been derived from and should be read in conjunction with our consolidated financial statements and footnotes thereto included in the section beginning on page F-1.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in thousands, except per share data)			
2006 (unaudited)				
Total revenue	$ 15,034	$ 19,330	--	--
Gross margin	$ 6,481	$ 4,923	--	--
Basic net earnings per share	0.08	0.10	--	--
Diluted net earnings per share	0.07	0.08	--	--
2005				
Total revenue	$ 9,212	$ 12,280	$ 11,047	$ 11,802
Gross margin	$ 1,698	$ 2,667	$ 2,195	$ 4,342
Basic net earnings per share	$ 0.04	$ 0.06	$ 0.06	$ 0.08
Diluted net earnings per share	$ 0.04	$ 0.06	$ 0.05	$ 0.08
2004				
Total revenue	$ 3,502	$ 8,084	$ 8,054	$ 10,069
Gross margin	$ 1,249	$ 1,295	$ 1,372	$ 1,719
Basic net earnings per share	$ 0.02	$ 0.01	$ 0.02	$ 0.06
Diluted net earnings per share	$ 0.02	$ 0.01	$ 0.02	$ 0.04
2003				
Total revenue	$ 97	$ 123	$ 124	$ 873
Gross margin	$ 61	$ 76	$ 29	$ 353
Basic net loss per share	$ (0.12)	$ (0.04)	$ (0.03)	$ (0.02)
Diluted net loss per share	$ (0.12)	$ (0.04)	$ (0.03)	$ (0.02)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

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

The following factors could affect current and future results of Epro, which conducts our call center operations:

- insufficient sales forces for business development & account servicing;
- lack of PRC management team in operation;
- less familiarity with partners' product knowledge;
- deployment costs of a new HR application and the costs to upgrade the call center computer system;
- increasing costs of operations (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 collectibility of our trade receivables based on a combination of factors. We regularly analyze our significant customer accounts, and, when we become aware of a specific customer’s inability to meet its financial obligations to us, such as in the case of bankruptcy filings or deterioration in the customer’s operating results or financial position, we record a specific reserve for bad debt to reduce the related receivable to the amount we reasonably believe is collectible. We also record reserves for bad debt for all other customers based on a variety of factors including the length of time the receivables are past due, the financial health of the customer, macroeconomic considerations and historical experience. If circumstances related to specific customers change, our estimates of the recoverability of receivables could be further adjusted. In the event that our trade receivables become uncollectible, we would be forced to record additional adjustments to receivables to reflect the amounts at net realizable value. The accounting effect of this entry would be a charge to 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 EARNINGS

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.

RESULTS OF OPERATIONS

The following table sets forth selected consolidated income statement data as a percentage of revenues for the periods indicated.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2006 (%)	2005 (%)	2006 (%)	2005 (%)
Revenues	100	100	100	100
Cost of Revenues	(74.53)	(78.28)	(66.81)	(79.69)
Gross Margin	25.47	21.72	33.19	20.31
Selling, general and administrative expense	(19.17)	(12.01)	(23.79)	(11.16)
Earnings from operations	6.30	9.71	9.40	9.15
Earnings before income taxes, minority interest and discontinued operations	8.46	12.26	11.07	11.03
NET EARNINGS	4.13	4.83	5.00	4.69

THREE AND SIX MONTHS ENDED JUNE 30, 2006 COMPARED TO THREE AND SIX MONTHS ENDED JUNE 30, 2005

REVENUES. Revenues for the three and six months ended June 30, 2006 were $19,330,000 and $34,364,000, an increase of 57% and 60% from $12,280,000 and $21,492,000 for the three and six months ended June 30, 2005, respectively. During the second quarter and first half of 2006, revenues of $3,552,000, $5,517,000, $8,914,000 and $6,579,000, $12,557,000, $11,851,000 were derived from the services rendered by the Company’s three operating units: Outsourcing Services, Value-Added Services, and Communications Products Distribution Services, respectively. The revenues in product sales during the second quarter and first half of 2006 increased by 85.1% and 45.2% compared to the same periods of 2005. The revenues in services sales during the second quarter and first half of 2006 increased by 28.9% and 79.1% compared to the same periods of 2005.

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The increase in revenue was mainly due to the following sources:

(1) Outsourcing services: The year-over-year growth in outsourcing services in the second quarter and first half of 2006 was primarily due to the higher revenue from Call Centre business in Hong Kong. For the second quarter of 2006, Epro's revenues increased $643,000, or 26.8%, year-over-year, which was largely due to a 148% increase in revenues from facilities management services, and a 54% increase in revenue from outbound services. Its revenues accounted for 86% and 85% of total outsourcing services revenues in the second quarter and first half of 2006, respectively. Due to rising labor costs, management believes that Business Process Outsourcing (BPO) has become a firmly-entrenched trend in Hong Kong and the PRC. Demand for outsourcing services has been steadily increasing, especially in sectors such as banking, insurance and telecom, and such demand has lead to continued growth in the first half of 2006. The Company's combined Hong Kong-China operations expanded total contract center capacity to host 1000 working positions and to occupy a total of 53,000 square feet. During the first half of 2006, the outsourcing contract center in Hong Kong was at nearly full utilization. With increasing information technology expenditures by Hong Kong companies, both the Contact Center (or Customer Services Center) System and IT Solutions departments enjoyed revenue growth. Additionally, EPRO is the Value-added Reseller (VAR) of EPICOR's Customer Relationship Management Solution (CRM) and Enterprise Resource Planning Solution (ERP) which led to additional marketing activities and promotional programs in the first half of 2006. Management retains its positive outlook on its software operations as companies search for tools to streamline or automate their business processes. With an experienced technical support team, EPRO is able to provide end-to-end solutions to meet the increasing IT needs of clients.

(2) Value-added Telecom Services: In the aggregate, revenues received through VAS business and its subsidiaries accounted for 28.5% and 36.5% of the Company's total revenues for the three and six months ended June 30, 2006, respectively, and 38.6% and 28.6 % of the Company's total revenues for the three and six months ended June 30, 2005, respectively. Guangzhou 3G, Linkhead, Lion Zone contributed 12.8%, 8.9%, and 6.5%, respectively, of the total revenues for the three month ended June 30, 2006 and 13.1 %, 9.7% and 13.4%, respectively, for the six month ended June 30, 2006, respectively. During the second quarter and first half of 2006, China accounted for 37.5% and 45.8% of the total revenues, respectively, compared to 46.8 % and 37.4% in the same periods of 2005, respectively. The significant increase in revenues during the second quarter of 2006 and a small increase during the first half of 2006 in Guangzhou 3G was mostly attributed to providing new 3G services and through the merger of Guangzhou Wanrong, which added approximately $308,000 and $574,000 to three and six months ended June 30, 2006, respectively. On a year-over-year basis, the Company's VAS revenue only increased a small percentage, approximately 16% in the second quarter, which is primarily attributed to the approximate 20% decline in the sales of voice cards from Linkhead. During 2006, there was a general market decline for voice cards in Asia, and a 25% decline in SMS revenues from Clickcom in which SMS advertising has been restricted by China Information Industry Department. However, voice cards revenues had a slight increase of 5% ($81,000) quarter-to-quarter. Additionally, the development of WAP and color ring back tone services had growth during the period to partially offset the decline in SMS business. Separately, stricter guidelines established by the China Securities Regulatory Commission (CSRC) led to a decrease in the Company's ability to market its investment consulting services to retail audiences, which resulted in a revenue underperformance. Nevertheless, although barriers

remain on marketing through television, the Company has successfully expanded its use of stored-value cards to maintain its market position. Due to its large loyal retail following, the Company believes it can work through the current regulatory environment. Additionally, the Company has shifted its marketing emphasis to the internet and magazines.

(3) Communication Products Distribution: iMobile added approximately $1,230,000 and $2,231,000, or accounted for 13.8% and 18.8% in Communication Products Distribution revenues for the three and six months ended June 30, 2006, respectively, in which its major business included internet sales of mobile phone and accessories. The revenues from the sales of Motorola and Nokia contributed 95% of iMobile's total revenues during the second quarter and first half of 2006. Additionally, the completion of a charging platform for new services and content information is in process and is expected to be rolled out in August of this year. PacCom revenues accounted for 54 % and 8 % of total revenues in the Communication Products Distribution business in the first half of 2006 and 2005, respectively. Revenues from PacCom increased by 2535% and 811% year-over-year in the second quarter and first half of 2006, respectively, primarily due to approximately $1.9million (HK$15million) revenues from providing LED lighting technology and solution for Galaxy Starworld Hotel of Macau and approximately $0.23million (HK$1.78million) revenues from Dell computer, Fiber Converter, Mirror Finish Steel, Cabling, DCM player, and others during the second quarter of 2006.

(4) The remaining incremental revenues for the three and six months ended June 30, 2006 as compared to respective period was derived from organic growth from existing subsidiaries, such as PacPower ($894,000 and $2,474,000) and PacificNet Limited ($407,000 and $825,000). The Light Eco installation system project awarded in the second quarter of 2006 posted positive revenue increases during the second quarter and first half of 2006. Additionally, projects involving $0.13million (HK$1.04million) of the installation of Central Air-Conditioning Chilled-Water Pump Intelligence Control System at the incorporate owner of Goodrich Garden and $0.96million (HK$7.50million) of Nan Fung Centre chiller replacement project strongly help pushed drive revenues. The Company also received two services agreements during the second quarter of 2006 including providing consulting services in the areas of legal, accounting, finance, management and web site design and construction (HK$1million), and providing Internet e-commerce software application and e-commerce web site development service (HK$1.5million).

Acquisitions during the first quarter of 2006 also expanded PacificNet's position as a leading provider of e-commerce, customer services and CRM in China's mobile distribution market, and increased our e-commerce and VAS revenues and our nationwide CRM service coverage. Several of our businesses experienced fluctuations in quarterly performance. Revenues from the VAS and IVR segment can vary from quarter to quarter due to new products and services launches and, the seasonality of certain product lines.

Summarized financial information concerning each of our main operating units is set forth in the following table. The "Other Business" column included our other insignificant subsidiaries and corporate related items.

FOR THE THREE MONTHS ENDED

JUNE 30, 2006	Group 1 Outsourcing Business ($)	Group 2. VAS Business ($)	Group 3 Communications Distribution Business ($)	Group 4 Other Business ($)	TOTAL ($)
Revenues	3,552,000	5,517,000	8,914,000	1,347,000	19,330,000
Earnings / Loss from Operations	283,000	1,130,000	208,000	(404,000)	1,217,000

FOR THE SIX MONTHS ENDED

JUNE 30, 2006	Group 1 Outsourcing Business ($)	Group 2. VAS Business ($)	Group 3 Communications Distribution Business ($)	Group 4 Other Business ($)	TOTAL ($)
Revenues	6,579,000	12,557,000	11,851,000	3,377,000	34,364,000
Earnings / Loss from Operations	403,000	2,844,000	265,000	283,000	3,229,000

COST OF REVENUES. Cost of revenues for the three and six months ended June 30, 2006 was $14,407,000 and $22,960,000, an increase of 49.9% and 34.1% from $9,613,000 and $17,127,000 for the three and six months ended June 30, 2005, respectively. The cost of revenues in services and product sales in the second quarter and first half of 2006 increased by 3.8% and 81.1%, respectively, and 17.4% and 43.5%, respectively, compared with the respective period in 2005. The increase is directly associated with the corresponding increase in revenues. In comparison to the same period last year, the majority of the costs associated with revenues were from PacCom and Epro. For the second quarter and first half of 2006, PacCom accounted 34.1% and 26.9% of the total cost of revenues, respectively and approximately $1.86million (HK$14.5million) cost of revenue from PacCom is the IT equipment cost paid for Macau Galaxy Starworld Hotel project during the second quarter of 2006. Cost of revenues from Epro accounted for 15.7% and 18.7% of the total cost of revenues in the first half of 2006 and 2005, respectively, which was mainly related to 27% increase in staff cost related to software sales, 277% increase in occupancy costs such as rents and electricity and 46% increase in other operating activity. Additionally, 4% and 8.2% of total cost of revenues was contributed from PacPower for the second quarter and first half of 2006, respectively, which resulted from a Central Air-Conditioning chiller replacement project and a Light Eco installation system project awarded during the first and second quarter of 2006 respectively. In addition, PacPower received a contract for a frequency inverter energy-saving air-conditioning solution project from a client.

GROSS PROFIT. Gross profit for the three and six months ended June 30, 2006 was $4,923,000 and $11,404,000, a significant increase of 84.6% and 161.3 % as compared to $2,667,000 and $4,365,000 for the three and six months ended June 30, 2005, respectively. Gross margin was 25.5% and 33.2% of total revenues for the second quarter and first half of 2006, compared to 21.7% and 20.3% for the second quarter and first half of 2005, respectively. As explained above, the improvement on gross margin for three and six months periods from the prior periods was primarily due to contributions from higher margin subsidiaries. The significant increase in gross margin year-over-year came primarily from our facilities management and outbound services, and mobile phone sales. One of our subsidiaries transformed its operation from a resource outsourcing basis to more of a project outsourcing basis. For resource outsourcing, we had high revenue and low profit margin in the second quarter and first half of 2005. As a result of the shift in operations, we had lower revenue and higher than normal profit margin for project outsourcing in the second quarter and first half quarter of 2006. We believe that our overall gross margins approximate the industry standards and we expect our gross margin percentage to increase gradually as a result of cost reduction and greater efficiencies in our utilization of assets.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses totaled $3,177,000 and $7,500,000 for the three and six months ended June 30, 2006, an increase of 131% and 232% from $1,376,000 and $2,257,000 for the three and six months ended June 30, 2005, respectively. General and administrative expenses consist primarily of staff salaries, rent, insurance and traveling costs. The year-over-year increase in total general and administrative expenses in the second quarter and first half of 2006 was mainly due to the increase of staff cost as well as rent and electricity expenses for the expansion of call centre. The marketing expenses from the new 3G service and Wanrong’s services also significantly affected the total expenses during the second quarter of 2006, increasing approximately 288% compared to the same period in 2005. Furthermore, the expenses from project outsourcing services included traveling and training expenses.

The sharp increase in the second quarter and first half of 2006 for PACT SZ was primarily due to 25% and 24 % increase of salary cost from the expansion of accounting, auditing, SOX internal control and Kingdee software maintenance teams, a 495% and 292% increase from staff traveling cost resulting from the annual audit and the increase in management fees from the regular annual board and audit committee meetings in SZ. Most of the subsidiaries had representatives attend the meetings to present their previous one year and current period's business financial performance and their forecasts for quarterly financial figures. Open and transparent communication is essential as it improves the relationship between PACT and each subsidiary so that each company can know more about the others' business operation. In order to meet the requirements of Sarbanes-Oxley Act (SOX 404), it is essential to have adequate internal controls and procedure, and to improve efficiency by using accounting software.

Significant general expenses from PacificNet Inc. year-over-year in the second quarter and first half of 2006 was largely due to $58,334 and $120,043 of vesting option expense for compensation cost amortization, $27,500 increase in D&O commercial insurance expense (the total prepayment of $110,000 for its insurance was from June 2005 to June 2006), $85,996 amortization cost from $8 million convertible debt issuance cost (3 years amortization) and depreciation cost from Beijing Time court (USD1.6m depreciated through 40 years). Additionally, there is approximately $148,080 financial expense for PacificNet Inc. Such expense consists of (1) convertible debt interest, in which 5% is prepaid interest expense, $100,000 is expensed in Q2 2006 and the following three quarters (Q3 2006, Q4 2006 and Q1 2007); and (2) the bank loan interest for Beijing Time Court ($57,969) in which the total amount of its bank loan is $1,082,000.

EARNINGS FROM OPERATIONS. On a year-over-year basis, earnings from operations increased 2% and 64% in the second quarter and first half of 2006, respectively. Operating earnings of $283,000, $1,130,000, and $208,000 for the three months ended June 30, 2006 were generated from the Company's three business units: (1) CRM Outsourcing Services, (2) Value Added Services (VAS), and (3) Communications Distribution Services, respectively. This compares to operating earnings of $305,000, $1,086,000 and $118,000 for the three months ended June 30, 2005, respectively. Various factors affected operating earnings during the second quarter of 2006, including increased capital expenditures resulting in greater non-cash charges such as depreciation and amortization expenses. As the Company expanded its call centre sites in Hong Kong, amortization and depreciation expenses related to the new leasehold improvement, furniture & fixtures, computer equipment and software incurred in the second quarter and first half of 2006 also increased. The increase in fixed assets also included a recorder monitor system, DVCAM, computer equipment. We continued to shift our business from our traditional lower-margin distribution business (B2B services) to higher margin value-added telecom services and B2C e-commerce which we believe will help drive superior bottom-line results. We believe that the Company has made substantial progress in a relatively short period of time which has been demonstrated by our increase in both gross and operating margins in the second quarter. Furthermore, the acquisition of the majority interest in both iMobile and Guangzhou Wanrong during the first quarter enhanced our position in this rapidly growing B2C market in China.

INCOME TAXES. Income tax provision was $85,000 and $200,000 for the three and six months ended June 30, 2006, as compared to $37,000 and $64,000 for the three and six months ended June 30, 2005. Interim income tax provisions are based upon management's estimate of taxable income and the resulting consolidated effective income tax rate for the full year. As a result, such interim estimates are subject to change as the year progresses and more information becomes available. We expect our income taxes to increase as our net earnings increase and the tax holidays we have benefited from in Hong Kong and the PRC expire.

MINORITY INTERESTS. Minority interests for the second quarter and first half of 2006 totaled $804,000 and $1,934,000 compared with $887,000 and $1,304,000 for the same period in the prior year, representing outside ownership interests in subsidiaries that is consolidated with the parent for financial reporting purposes.

NET EARNINGS. Overall net earnings year-over-year increased 34.6% and 70.5% in the second quarter and first half of 2006, respectively. The Company's results for the six months ended June 30, 2006 included a total of $888,000 in non-cash expenses, including depreciation and amortization expense of $768,000 and $120,000 non-cash stock-based compensation expense recognized during 2006 as a result of the implementation of SFAS 123(R), which we adopted effective on January 1, 2006. The Company's quarterly results also included a total of $530,000 in non-cash expenses, including depreciation and amortization expense of $472,000 and non-cash stock-based compensation expense $58,000 recognized during the second quarter as a result of the implementation of SFAS 123(R), which we adopted effective on January 1, 2006. Each of our subsidiaries and investments, including Epro, Smartime, Guangzhou 3G, Clickcom, ChinaGoHi, iMobile, PacificNet Communications, PacificNet Limited and PacificNet Power were profitable.

In the outsourcing business, Smartime signed an outsourcing contract with a local Bank in Hong Kong, Wing Lung Bank, in May which will help drive growth in the outsourcing business, and provide a platform for further penetrating this market in the region. Smartime provided some senior engineers for the Bank and will also jointly recruit some recently-graduated students and train them. Furthermore, the Company is constantly seeking new channels to provide lower prices for resources, leading to lower operating costs.

Two recently acquired subsidiaries, iMobile and Wanrong, also added approximately $2 million and $268,000 net profit, respectively, to the total amount of net profit during the second quarter of 2006. With the new operation of 2, 2.5 and 3G VAS services, net profit has rapidly increased. PacificNet Limited and PacificNet Power also added approximately $214,000 and $296,000 net profit, respectively, to the Company due to newly obtained projects during the second quarter of 2006. Overall, management is optimistic in our ability to drive revenue and profits quarter-to-quarter as a result of cost reductions and efficient utilization of assets.

RESULTS OF OPERATIONS

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

	Year Ended December 31 2005 (%)	**Year Ended December 31 2004 (%)**	**Year Ended December 31 2003 (%)**
Revenue	100	100	100
Cost of revenue	(75.4)	(81.0)	(57.4)
Gross margin	24.6	19.0	42.6
Selling, general and administrative	(13.2)	(11.6)	(129.2)
Depreciation and amortization	(0.7)	(0.3)	(6.2)
Earnings from operations	10.3	6.5	(109.8)
Interest (expenses) income, net	0.1	0.3	2.2
Sundry income	1.9	1.4	4.4
Provision for income taxes	(0.5)	(0.1)	(2.6)
Share of profit of associated companies	(0.00)	0.1	--
Minority interest	(6.6)	(5.5)	5.8
Discontinued operations	—	(0.1)	--
Net earnings	5.6	2.6	(105.3)

REVENUE. Revenue for the year ended December 31, 2005 was $44,341,000, an increase of 49% as compared to $29,709,000 for the year ended December 31, 2004. The increase in revenue was mainly due to revenue derived from the value-added telecom services rendered by the Company's newly acquired subsidiaries, Guangzhou3G ($3,143,000), Clickcom ($365,000) and Lion Zone ($1,194,000). In the aggregate, the three newly acquired subsidiaries contributed to 11% of the total revenue. Revenue from the VAS and IVR segment can vary from quarter to quarter due to new product launches and the seasonality of certain product lines. The "Other Business" column includes the revenue and earnings/(loss) from operations of our other insignificant subsidiaries. Summarized financial information for each of our four business operating segments is set forth in the table below.

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

For the year ended December 31, 2005	Group 1 Outsourcing Business ($)	Group 2 VAS Business ($)	Group 3 Communications Distribution Business ($)	Group 4 Other Business ($)	Total ($)
Revenue	13,505,000	13,834,000	16,201,000	801,000	44,341,000
(%) of Total	(30.5%)	(31.2%)	(36.5%)	(1.8%)	(100%)
Earnings/(Loss) from Operations	1,360,000	3,899,000	558,000	(1,248,000)	4,569,000

(1) OUTSOURCING SERVICES

Revenue for the year ended December 31, 2005 was $13,505,000, an increase of 44% as compared to $9,385,000 for the year ended December 31, 2004. Outsourcing services revenue made up 26.54% of the Company's total revenue for the fourth quarter of the year 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 revenue increased is due to the continuous rapid growth on computer software product and the company provides a seamless solution and multi-media channels for clients to communicate with their customers for building better customer relationship and generating more sales revenue. The combination of its innovative infomercials along with our growing call center operations will allow us to support significant future growth. 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 SERVICES

VAS revenue for the year ended December 31, 2005 was $13,834,000, a significant increase of 142% as compared to $5,724,000 for the year ended December 31, 2004. Our acquisition of 3G, Clickcom and Lion Zone in 2005 contributed to the increase in revenue for this business segment and helped us enter the mobile Internet market in China. VAS revenue made up 49.1% of the Company's total revenue for the fourth quarter of the year. Presently, approximately 80% of mobile phone users use VAS in China. The Company's revenue in the sales of voice cards continued to grow through Linkhead-generated NMS cards and with the cards increasing use in voice hardware equipment, based on CPCT industry control machines and Media Server which supports access from both PSTN and VoIP, softswitch and 3Gnetworks. 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 cardsFor 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.

(3) COMMUNICATION PRODUCTS DISTRIBUTION

Revenue for the year ended December 31, 2005 was $16,201,000, an increase of 37% as compared to $11,790,000 for the year ended December 31, 2004. Its revenue remained steady growth during the year due to the increasing market growth in communication products distribution services. Communication products distribution revenue made up 20.3% of the Company's total revenue for the fourth quarter of the year. In FY2005, sales mix of high-margin products such as number cards and IP cards increased whereas substantial portion of FY2004 revenue were derived from low-margin prepaid stored-value cards. This improved sales mix was achieved through sales incentive scheme. Furthermore, we believe that our Take1 and My Memory Maker Kiosks are a natural fit in the self-service vending machine, party, amusement, and casino market, and we also believe there are strong opportunities for growth in high-traffic tourist and amusement destinations. Recently, the Company had entered into a definitive agreement to acquire iMobile in order to enhance our position in this rapidly growing B2C market in China.

COST OF REVENUE AND GROSS MARGIN. Cost of revenue for the year ended December 31, 2005 was $33,439,000 an increase of 38% from $24,074,000 for the year ended December 31, 2004. The slight increase in the cost of revenue was directly associated with the increase in revenue. Cost of revenue, as a percentage of revenue, was 75% for the year ended December 31, 2005 as compared with 81% for the year ended December 31, 2004. The decrease in percentage cost of revenue 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 $10,902,000 an increase of 93% as compared to $5,635,000 for the year ended December 31, 2004, resulting from gross margin contributions from our newly acquired subsidiaries in 2005. Gross profit for the fourth quarter of the year was $5,047,000, a significant increase of 265% as compared to $1,379,000 for the same period in 2004; or a significant increase of 153% as compared to the third quarter of 2005.

We believe that our gross margin overall approximates the industry standards. The significant increase in gross margin came primarily from, our phone card business, which has higher gross margins, typical for that industry. We expect our gross margin percentage to increase gradually as a result of cost reduction and efficient utilization of assets.

(1) OUTSOURCING SERVICES

As compared to prior year, cost of revenue for outsourcing services increased by 55% to $10,095,000 (2004: $6,491,000). Gross profit was 4% lower at $3,409,000 (2004: $3,543,000). Gross profit of $1,069,000 for the fourth quarter had a significant increase of 56% as compared to $682,000 for the third quarter of 2005 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. The slightly decline year over year was primarily due to the enhanced Hong Kong market competition.

However, 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 SERVICES

As compared to prior year, cost of revenue for VAS increased by 75% to $7,715,000 (2004: $4,403,000). Gross profit was 262% much higher at $6,119,000 (2004: $1,688,000). Gross profit of $3,241,000 for the fourth quarter also had a significant increase of 471% as compared to the same period in 2004; or an increase of 184% as compared to $1,141,000 for the third quarter of 2005. Throughout the new acquisitions in 2005 such as Lion Zone with higher gross margin, it moved our strategic consolidation in China's CRM and VAS market, and increased our customer base and improved our gross margin. The increasing gross profit is also derived from the continued profitability in the sale of phone cards. Furthermore, Company increased market share in the voice/IVR supplier market.

(3) COMMUNICATION PRODUCTS DISTRIBUTION

As compared to prior year, cost of revenue for communication products distribution slightly increased by 17% to $15,347,000 (2004: $13,106,000). Gross profit was 194% higher at $854,000 (2004: $290,000). The fourth quarter is normally the strongest due to holiday-related promotions which increase the spending of our customers with us and therefore higher margin was expected. Furthermore, since revenue made up the highest rate of 36.5% of the Company's total revenue and cost of revenue had only slightly increased in 2005, its gross profit relatively increased more to reach our future expectation. As one of its subsidiaries, Shanghai Classic Group Limited (Yueshen) signed an agreement to become a designated integrated services distributor of China Mobile in 2005, it increased the Company's overall distribution revenue and profit margin. The improved gross margin was mainly due to increased sales mix from higher margin products such as number cards with average gross margin of 8 to 15% and IP calling cards with average gross margin of 30% instead of low-margin prepaid stored-value cards with just around 2% gross margin.

(4) OTHER BUSINESS

Cost of revenue and gross profit for PacificNet Power for the year ended December 31, 2005 was $269,000 and $67,000. PacificNet Power did not exist in 2004, so no comparison is available for 2004.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, General and Administrative expenses totaled $5,811,000 for the year ended December 31, 2005, an increase of 69% from $3,435,000 for the year ended December 31, 2004. As our fourth quarter results included several one-time charges or expenses such as the $103,250 NASDAQ National Market Entry Fee, quarterly SG&A had significant increase of 183% as compared to the third quarter of the year. The increase in selling, general and administrative expenses reflected the expansion of our operations of which expenses were incurred by our newly acquired subsidiaries 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 $1,628,000 for the year ended December 31, 2005, a reduction of $502,000 from $2,130,000 for the year ended December 31, 2004. Due to the increase in the demand for telemarketing and call center services, one of the subsidiaries purchased a new 250-seat call center facility in China, to support the rapidly growing business of the company. It caused an increase of 103% to $482,000 for SG&A for the fourth quarter of the year. 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 SERVICES

Selling, General and Administrative expenses for VAS were $2,159,000 for the year ended December 31, 2005, an increase of $2,072,000 as compared to $87,000 in 2004. The increase of SG&A resulted from increasing the size of our operations which included premises costs and staff costs from the three new acquisitions.

(3) COMMUNICATION PRODUCTS DISTRIBUTION

Selling, General and Administrative expenses for communication products distribution were $271,000 for the year ended December 31, 2005, an increase of 188% as compared to $94 for the year ended December 31, 2004. This business is easily scalable depending on the availability of working capital, since one of the subsidiaries, Shanghai Classic, needs to pay the telephone operators/suppliers cash upfront.

(4) OTHER BUSINESS

Selling, General and Administrative expenses were $167,000 for the year ended December 31, 2005.

DEPRECIATION AND AMORTIZATION EXPENSES. Depreciation and amortization expenses were $1,126,000 for the year ended December 31, 2005, which represented 1344% increase as compared to the year ended December 31, 2004 of which depreciation and amortization expenses was $78,000.

EARNINGS FROM OPERATIONS. Operating profit of $4,569,000 for the year ended December 31, 2005, a significant increase of 136% as compared to $1,937,000 from the year ended December 31, 2004. Operating margins nearly doubled to 10.3% from 6.5% in the previous year. Quarterly operating profit was $1,702,000, an increase of 66% as compared to $1,026,000 from Q3 2005. Quarterly operating profit of $380,000, $1,470,000, and $254,000 generated from the Company's three business units: (1) CRM Outsourcing Services, (2) Value-Added Services (VAS) and (3) Telecom Distribution Services, represented an increase of 75%, 50% and 47% respectively. These are compared to $217,000, $974,000, and $172,000 respectively for Q3 2005. Operating profit of $1,360,000, $3,899,000 and $558,000 generated from business units (1), (2) and (3) for the year ended December 31, 2005 represented an increase of 36%, 110% and 556% respectively, as compared to $1,000,000, $1,859,000, and $85,000 respectively for the year ended December 31, 2004. The increase in operating margin reflects Company's continuous shift away from our traditional lower-margin phone card distribution business (B2B services) to higher margin value-added telecom services and B2C e-commerce. We believe that in 2006 this strategy will result in increased profitability. This strategy is beginning to work, as our operating margin increased from 6.5% in 2004 to 10.3% in 2005.

INTEREST EXPENSES / INCOME. Interest income was $246,000 for the year ended December 31, 2005, an increase of 211% as compared to $79,000 for the year ended December 31, 2004. The increase is due to 62% of interest income generated from PacificNet Communications. Interest income was mainly generated from $152,000 of PacificNet Communications from lending and fixed-rate bank deposits (62% of total interest income) and $45,000 of PacificNet Strategic Investment Holdings Limited from bank deposits. Interest expenses were $229,000 for the year ended December 31, 2005, an increase of 24% as compared to $185,000 for the year ended December 31, 2004. Most of the interest expenses were attributed to bank loans by PacificNet Strategic Investment Holdings ($34,000) and Linkhead ($26,000), and bank loans and bank overdraft by Epro ($133,000).

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 mainly derived from Linkhead's consulting services income from system integration services totaling $380,000.

For the year ended December 31, 2005, the non-operating income or sundry income was $830,000 included in Statement of Operations was mainly derived from the consulting services income of $116,000, software service income of $375,000, investment income of $113,000, leasehold income of $75,000 and various other totaling $151,000.

SHARE OF PROFIT OF ASSOCIATED COMPANIES. We recorded the loss of $8,000 for the year ended 2005 with respect to our 20% ownership interest in Take1 Technology (Cheer Era Limited), acquired in April 2004.

INCOME TAXES. The income taxes expenses for the Company's subsidiaries were $222,000 for the year ended December 31, 2005. The provision of income taxes was the result of the operating profit generated by Guangzhou3G, Clickcom and ChinaGoHi, the subsidiaries we acquired in 2005. 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 year ended December 31, 2005 totaled $2,926,000. Minority interests represented the interests of third parties in our subsidiaries' results.

NET EARNINGS. Net earnings for the year ended December 31, 2005 was $2,489,000 as compared to net earnings of $774,000 for the year ended December 31, 2004. Operating profit of $1,360,000, $3,899,000 and $558,000 generated from the Company's three business units: (1) CRM Outsourcing Services, (2) Value-Added Services (VAS) and (3) Telecom Distribution Services, represented an increase of 36%, 110% and 556% respectively as compared to $1,000,000, $1,859,000, and $85,000 respectively for the year ended December 31, 2004. The overall net earnings increased sharply due to (i) the Company acquired direct response television and infomercial marketing services company in China which received an award by the Chinese tax bureau as one of the "Top 100 Tax-Paying Enterprises" in Shenzhen as recognition for profit generation, commercial leadership and government contribution; (ii) launched a new Mobile Mailbox Service called "UMAIL" for Unicom's CDMA users on its WAP Portal website; (iii) signed up China Mobile for New Blog Service and so forth. Furthermore, the new facility in China should lead to growth in profit margin because the labor cost and office facility is less than half of the cost in Hong Kong.

YEAR ENDED DECEMBER 31, 2004 COMPARED TO YEAR ENDED DECEMBER 31, 2003

REVENUES. Revenues for the year ended December 31, 2004 were $29,709,000, an increase of $28,492,000 from $1,217,000 for the year ended December 31, 2003. Increase in revenue was mainly due to revenues derived from the call center and value-added telecom services rendered by the Company's newly acquired subsidiaries of YueShen, Epro, Linkhead and Smartime. In the aggregate, the four newly acquired subsidiaries contributed to 91% of total revenues. Summarized financial information concerning each of these subsidiaries was set forth in the following table. The "Admin & Other" column included our other insignificant subsidiaries and corporate related items.

For the year ended December 31, 2004	**Group 1 Outsourcing Business ($)**	**Group 2 VAS Business ($)**	**Group 3 Communications Distribution Business ($)**	**Admin & Other Business ($)**	**Total ($)**
Revenue	9,385,000	5,724,000	11,790,000		