PACIFICNET INC
Form 10-Q
November 21, 2008

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

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

COMMISSION FILE NUMBER: 000-24985

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

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

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

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

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

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

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

As of October 31, 2008, there were 14,123,652 shares of the issuer's common stock, par value $0.0001 per share, outstanding.

PACIFICNET INC.

Form 10-Q for the Quarterly Period Ended September 30, 2008

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2008	December 31, 2007
ASSETS	(Unaudited)	
Current Assets:		
Cash and cash equivalents	$ 1,081	$ 1,911
Accounts receivables, net	2,949	3,990
Inventories, net	596	451
Loan receivable from related parties	2,326	2,273
Loan receivable from third parties	561	815
Marketable equity securities - available for sale	547	541
Current assets held for disposition	1,149	4,165
Receivable in lieu of disposed subsidiary, net	3,294	-
Other current assets, net	851	520
Total Current Assets	13,354	14,666
Property and equipment, net	4,038	4,375
Intangible assets, net	108	108
Investments - cost basis	294	120
Investment - equity method	3	13
Goodwill	1,079	602
Non-current assets held for disposition	707	1,678
Other receivables	-	1,499
TOTAL ASSETS	$ 19,583	$ 23,061
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Bank line of Credit	$ 5	$ 100
Bank loans-current portion	90	80
Accounts payable	72	72
Accrued expenses	3,237	3,402
Customer deposits	258	514
Convertible debenture	5,515	5,809
Liquidated damages liability	2,697	2,697
Shares to be issued	-	127
Liabilities related to entity held for disposition	3,038	4,251
Total Current Liabilities	14,911	17,051
Bank loans - non current portion	1,750	1,743
Convertible debenture-non current portion	-	-
Total long-term liabilities	1,750	1,743
TOTAL LIABILITIES	16,661	18,794

Minority interest		922		1,474
Commitments and contingencies				
Stockholders' Equity:				
Preferred stock, par value $0.0001, Authorized 5,000,000 shares				
Issued and outstanding - none		-		-
Common stock, par value $0.0001, Authorized 125,000,000 shares				
Issued and outstanding:				
September 30, 2008: 30,605,414 shares issued, 15,953,652 outstanding				
December 31, 2007: 16,887,041 issued, 14,314,072 outstanding		1		1
Treasury stock, at cost(2008Q3: 14,651,762 shares; 2007: 2,572,969 shares)		(159)		(145)
Additional paid-in capital		72,460		79,125
Shares issued as deposit		-		(10,974)
Cumulative other comprehensive income (loss)		(1,022)		200
Accumulated deficit		(68,951)		(65,070)
Stock subscription receivable		(330)		(345)
Total Stockholders' Equity		1,999		2,792
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	19,583	$	23,061

The accompanying notes form an integral part of these un-audited consolidated financial statements.

1

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

	Three Months Periods Ended September 30,		Nine Months Periods Ended September 30,	
	2008	2007	2008	2007
Net Revenues				
Services	$ 4,648	$ 926	$ 2,867	$ 3,068
Product sales	1,000	4,328	12,200	12,246
Total Net Revenues	5,648	5,254	15,067	15,314
Cost of revenues				
Services	1,062	509	2,206	1,565
Product sales	3,866	3,565	10,302	10,073
Total Cost of Revenues	4,928	4,075	12,508	11,638
Gross Profit	720	1,179	2,559	3,676
Selling, general and administrative expenses	2,336	1,242	5,576	3,371
Depreciation and amortization	106	120	309	321
Total Operating Expenses	2,442	1,362	5,884	3,692
Loss From Operations	(1,722)	(183)	(3,325)	(16)
Other income (Expenses):				
Interest income/(Expenses), net	(130)	109	(352)	(313)
Share of earnings from investment on equity method	(9)	(23)	(101)	(23)
Other income, net	47	303	121	430
Total Other Income (Expenses)	(92)	171	(332)	94
Income (Loss) from continued operations before Income Taxes and Minority Interest	(1,813)	(11)	(3,657)	79
Provision for income taxes	3	-	3	-
Minority interests	171	3	326	(524)
Loss from Continued Operations	(1,639)	(8)	(3,328)	(445)
Gain (Loss) on disposal	(25)	46	(83)	(925)
Income/ (Loss) from discontinued operations	(275)	(259)	(992)	730
Total income/ (Loss) from discontinued operations	(300)	(213)	(1,076)	(195)
Net Loss	(1,939)	(220)	(4,404)	(639)
Other comprehensive income (Loss):				
Foreign currency translation gain (loss)	(199)	(76)	(365)	(21)
Unrealized loss on marketable securities	(584)	-	(857)	
Net Comprehensive Income (Loss)	$ (2,722)	$ (144)	$ (5,625)	$ (660)

BASIC EARNINGS (LOSS) PER COMMON SHARE:								
Loss per share-Continued Operations	$	(0.11)	$	(0.00)	$	(0.22)	$	(0.03)
Loss per share-Discontinued Operations	$	(0.02)	$	(0.02)	$	(0.07)	$	(0.02)
Basic – Income (Loss) per share	$	(0.13)	$	(0.02)	$	(0.29)	$	(0.05)
DILUTED EARNINGS (LOSS) PER COMMON SHARE:								
Loss per share-Continued Operations	$	(0.13)	$	(0.00)	$	(0.22)	$	(0.03)
Loss per share-Discontinued Operations	$	(0.02)	$	(0.02)	$	(0.07)	$	(0.02)
Diluted – Income (Loss) per share	$	(0.13)	$	(0.02)	$	(0.29)	$	(0.05)
Weighted average number of shares-Basic		14,763,009		11,931,094		15,226,975		11,805,686
Weighted average number of shares- Diluted		14,763,009		12,027,315		15,226,975		11,858,870

The accompanying notes form an integral part of these un-audited consolidated financial statements.

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

	For the Nine Month Periods Ended September 30, 2008	2007
Cash Flows From Operating Activities		
Net Loss	$ (4,404)	$ (639)
Adjustment to reconcile net earnings/(loss) to net cash provided by (used in) operating activities:		
Provision for allowance for doubtful accounts	456	1,083
Minority Interest	(326)	524
Amortization of debt discount	357	-
Depreciation and amortization	309	321
Share of earnings from investment on equity method	101	23
Loss/(gain) from discontinued operations	1,075	195
Stock-based compensation	670	-
Change in fair value of derivatives	-	(143)
Changes in current assets and liabilities net of effects from purchase of subsidiaries:		
Accounts receivable and other current assets	(1,716)	(618)
Inventories	(145)	(365)
Accounts payable and other accrued expenses	903	964
Net cash provided by (used in) operating activities of continued operations	(2,720)	1,345
Net cash provided by operating activities of discontinued operations	-	2,488
Net cash provided by (used in) operating activities	(2,720)	3,833
Cash Flows From Investing Activities:		
Increase in purchase of marketable securities	-	(474)
Acquisition of property and equipment	8	(828)
Acquisition of subsidiaries and affiliated companies	(60)	-
Repurchase of treasury shares	(15)	127
Net cash provided by (used in) investing activities of continued operations	(67)	(1,175)
Net cash provided by investing activities of discontinued operations	$ 1,897	$ 122
Net cash provided b y(used in) investing activities	$ 1,830	$ (1,053)
Cash Flows From Financing Activities:		
Loans receivable from third parties	109	(1,361)
Loans receivable from related parties	166	(521)
Loans payable to related party	-	212
Advances (repayments) under bank line of credit	(95)	20
Proceeds from exercise of stock options and subscription	-	96
Advances under bank loans	17	766
Net proceeds from issuance of convertible debenture	(150)	(1,790)
Net cash provided by(used in) financing activities of continued operations	47	(2,578)
Net cash provided by(used in) financing activities of discontinued operations	-	-
Net cash provided by(used in) financing activities	47	(2,578)
Effect of exchange rate change on cash and cash equivalents	13	20

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	$	(830)	$	222
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		1,911		1,778
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	1,081	$	2,000
SUPPLEMENTAL CASH FLOW INFORMATION:				
Interest paid	$	(6)	$	-
Income taxes paid	$	(3)	$	-
NON-CASH INVESTING AND FINANCING ACTIVITIES:				
Investments in subsidiaries and affiliate through issuance of common stock	$	229	$	-
Issuance of common stock for payment of convertible debenture		501		-
Options exercised for shares receivable		-		484
Investment in marketable securities by issuing shares		1,245		-
Issuance of shares as a part of acquisition agreement		593		-
Issuance of shares for accrued compensation		1,087		-
Redemption of convertible debenture	$	-	$	1,091

The accompanying notes form an integral part of these un-audited consolidated financial statements.

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

1. BASIS OF PRESENTATION

Description of Operations - PacificNet Inc. ("PacificNet" or the "Company") is a leading provider of e-commerce, gaming and mobile game technology worldwide with a focus on emerging markets in Asia, Latin America and Europe. PacificNet's gaming products are localized to their specific markets creating an enhanced user experience for players and larger profits for operators.

Consolidated Interim Financial Statements - The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial reporting consistent in all material respects with those applied in the Company's Annual Report on Form 10-K, as amended, for the year ended December 31, 2007, but do not include all disclosures required by GAAP. You should read these interim consolidated financial statements in conjunction with the audited financial statements, including the notes thereto, and the other information set forth in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. The unaudited consolidated financial statements include the accounts of PacificNet Inc. and its subsidiaries and variable interest entities ("VIEs") for which the Company is the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all material adjustments considered necessary for a fair presentation of the Company's interim results have been reflected. PacificNet's 2007 Annual Report on Form 10-K includes certain definitions and a summary of significant accounting policies and should be read in conjunction with this report. The results for interim periods are not necessarily indicative of annual results.

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

Reclassification - Certain items in the accompanied consolidated financial statements have been reclassified for comparative purposes.

Going Concern

As shown in the accompanying consolidated financial statements, the Company incurred accumulated losses of $69 million and $65 million as of September 30, 2008 and December 31, 2007, respectively. Negative cash flows used in the operations were $2.72 million for the nine months ended September 30, 2008. These matters raise substantial doubt about the Company's ability to continue as a going concern.

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

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

On April 18, 2008, the Company entered into a Sale and Purchase agreement to dispose of its equity interest in PacificNet Epro Holdings Limited for a consideration of HK$21 million (See Note 12).

On August 18, 2008, the Company entered into a purchase agreement to acquire 19% equity interest of a Chinese lottery company called Universal KingLott (Beijing) Tech Co., Ltd. (See Note 14)

On September 1, 2008, the Company entered into a purchase agreement to acquire 18% equity interest of Guangdong Poly Blue Express Communications Co., Ltd. (See Note 14)

On September 4 through 23, 2008, the Company entered into various definitive agreements to dispose and reduce its equity interests in certain money losing non-gaming operations from 15% to 0%, namely: MOABC, Clickcom, Pacificnet Solutions Limited (PacSo), Pacificnet Power Limited (PactPower). The company also entered into a definitive agreement with Pacificnet Ad Limited (PacAd) to dispose and reduce its equity interests from 19% to 0%.

On March 27, 2008, three holders of PacificNet's Convertible Subordinated Debentures filed an involuntary petition for Chapter 11 relief in federal bankruptcy court on Saturday, March 22, 2008 in Wilmington, Delaware. The Company retained counsel to oppose the filing because the petition fails to meet the standard for invoking an involuntary bankruptcy and fails to take into consideration other agreements between the Company and the petitioning creditors. Subsequently, PacificNet also received default notice from all but one of the debenture holders including Iroquois Master Fund Ltd., Alpha Capital AG, Whalehaven Capital Fund Limited, DKR Soundshore Oasis Holding Fund Ltd., Basso Fund Ltd., Basso Multi-Strategy Holding Fund Ltd., and Basso Private Opportunities Holding Fund Ltd. from the same Convertible Subordinated Debentures related to the private offering of $8,000,000 principal amount variable debentures consummated on March 13, 2006, and due March 2009.

The amount of the debt in question was as follows: Iroquois Master Fund Ltd. $2.5 million, Whalehaven Capital Fund Limited $958,000, Alpha Capital AG $685,000 DKR Soundshore Oasis Holding Fund Ltd $960,000, and Basso Fund Ltd., Basso Multi- Strategy Holding Fund Ltd., and Basso Private Opportunities Holding Fund Ltd., a combined amount of $500,000.

As of August 29, 2008, PacificNet entered into a Settlement Agreement with certain bondholders who had filed an involuntary petition seeking Chapter 11 relief in Delaware federal bankruptcy court. Pursuant to the terms of the Settlement Agreement, the Company has amended and restated the terms of certain convertible debentures in the aggregate principal amount of approximately $6.2 million (the "Debentures"). Upon entering into the Settlement Agreement, the Company paid $150,000 of the obligations under the Debentures in cash and issued 668,321 shares of common stock to the bondholders upon conversion of a portion of the Debentures. The remaining outstanding Debentures in the aggregate principal amount of approximately $5.5 million are convertible at a conversion price of $2.00 per share, subject to the terms and conditions of the Debentures.

The settlement of debt hasn't changed the amount of debt (principal and accrued interests.) but the payment schedule. The settlement price is $0.75, no gain or loss on settlement of Debt. For the original 8M debentures, we should pay $5,162,415 (principal outstanding and accrued interest) as of August 29, 2008 (settlement date), we had paid $150,000 in cash and $501,000 in shares during the third quarter, the remaining $4,511,415 should be paid in 10 installments beginning October 15, 2008. In addition we owe $945,000 in new debentures and $58,000 accrued interests on the new debentures. As at September 30, 2008 we owe 5.5 million in old and new debentures including interest.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In May of 2008, FASB issued SFASB No. 163, Accounting for Financial Guarantee Insurance Contracts-an interpretation of FASB Statement No. 60. The scope of the statement is limited to financial guarantee insurance (and reinsurance) contracts. The pronouncement is effective for fiscal years beginning after December 31, 2008. The company does not believe this pronouncement will impact its financial statements.

In May 0f 2008, FSAB issued SFASB No.162, The Hierarchy of Generally Accepted Accounting Principles. The pronouncement mandates the GAAP hierarchy reside in the accounting literature as opposed to the audit literature. This has the practical impact of elevating FASB Statements of Financial Accounting Concepts in the GAAP hierarchy. This pronouncement will become effective 60 days following SEC approval. The company does not believe this pronouncement will impact its financial statements.

On March 19, 2008, FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities. The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Currently the Company does not carry any derivative instruments and the adoption of this statement may not have any effect on the financial statements.

In December 2007, FASB issued FASB Statement No. 160, Non-controlling Interests in Consolidated Financial Statements—an amendment of ARB No. 51. This Statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding non-controlling interest in one or more subsidiaries or that deconsolidate a subsidiary. Not-for-profit organizations should continue to apply the guidance in Accounting Research Bulletin No. 51, Consolidated Financial Statements, before the amendments made by this Statement, and any other applicable standards, until the Board issues interpretative guidance. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 (that is, January 1, 2009, for entities with calendar year-ends). Earlier adoption is prohibited. The effective date of this Statement is the same as that of the related Statement 141(R). This Statement shall be applied prospectively as of the beginning of the fiscal year in which this Statement is initially applied, except for the presentation and disclosure requirements. The presentation and disclosure requirements shall be applied retrospectively for all periods presented. Management is currently evaluating the effect of this pronouncement on financial statements.

6

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations". This Statement replaces SFAS No. 141, Business Combinations. This Statement retains the fundamental requirements in Statement 141 that the acquisition method of accounting (which Statement 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. This Statement also establishes principles and requirements for how the acquirer: a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquirement; b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase and c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) will apply prospectively to business combinations for which the acquisition date is on or after Company's fiscal year beginning October 1, 2009. While the Company has not yet evaluated this statement for the impact, if any, that SFAS No. 141(R) will have on its consolidated financial statements, the Company will be required to expense costs related to any acquisitions after September 30, 2009.

3. EARNINGS PER SHARE

Basic and diluted earnings or loss per share (EPS) amounts in the financial statements are computed in accordance with SFAS No. 128, "Earnings Par Share." Basic EPS is based on the weighted average number of common shares outstanding. Diluted EPS is based on the weighted average number of common shares outstanding plus dilutive common stock equivalents. Basic EPS is computed by dividing net income/loss available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period Diluted EPS is calculated by dividing net earnings by the weighted average number of common shares outstanding and other dilutive securities. Dilutive earnings per share for the period ended September 30, 2008 exclude the potential dilutive effect of all the 1,007,138 warrants outstanding because their impact would be anti-dilutive based on current market prices. 2,255,587 convertible debentures are tested by using if-converted method. The result shows when convertible debentures are included in the computation, diluted LOSS PER SHARE increases, therefore excluded from calculation as the effect is anti-dilutive. According to SFAS No.128, those convertible debentures are ignored in the computation of diluted EPS. All per share and per share information are adjusted retroactively to reflect stock splits and changes in par value.

The reconciliation of the numerators and denominators of the basic and diluted EPS calculations was as follows (IN THOUSANDS OF UNITED STATES DOLLARS, EXCEPT WEIGHTED SHARES AND PER SHARE AMOUNTS):

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Numerator: Net Earnings/ (Loss)	$ (1,939)	$ (220)	$ (4,404)	$ (639)
Denominator:				
Weighted-average number of shares –Basic	14,763,009	11,931,094	15,226,975	11,805,686
Weighted-average number of shares – Diluted	14,763,009	12,027,315	15,226,975	11,858,870
Basic Earnings/ (Loss) per share:	$ (0.13)	$ (0.02)	$ (0.29)	$ (0.05)
Diluted Earnings/ (Loss) per share:	$ (0.13)	$ (0.02)	$ (0.29)	$ (0.05)

4. OTHER CURRENT ASSETS

Other current assets consist of the following at September 30, 2008 (in thousands):

(USD ' 000s)	September 30, 2008 (Unaudited)	December 31, 2007
Prepayment to suppliers	$ 377	$ 175
Deposit	238	534
Loans to employees	188	273
Prepaid expenses	106	122
Loan to Golden Chapel	517	517
Other Receivables	916	518
Receivables WeiDa for disposal Linkhead	44	150
Loan to Beijing Webp	406	237
Loan to Mou Yi Liang	244	244
Loan to Bell-Pact Shanghai JV	-	102
Loan to Beijing UASIT	134	96
Provision for Doubtful Account	(2,320)	(2,448)
Total	$ 850	$ 520

5. GOODWILL AND BUSINESS ACQUISITIONS

The changes in the carrying amount of goodwill for the following reporting periods are summarized below:

(US$000s)	Group 1. Outsourcing Services	Group 2. Telecom Value-Added Services	Group 3. Products (Telecom & Gaming)	Total
Balance as of December 31, 2007	$ -	$ 193	$ 409	$ 602
Goodwill acquired during the first quarter	-	-	477	477
Balance as of September 30, 2008 (Unaudited)	$	$ 193	$ 986	$ 1,079

On January 5, 2008 the Company has a supplementary agreement with Take 1 Technology to issue all the shares as per the conditions set forth in the S&P agreement dated January 5, 2007. Based upon the supplementary agreement, the Company was required to issue the shares without the conditions on January 5, 2008. As a result, the Company issued 120,000 shares to Take 1 on January 9, 2008 valued at $477,000. The Company also issued 29,459 shares as committed on January 5, 2007 and classified as “Shares to be issued” as at December 31, 2007. The Company recorded 120,000 additional shares at the fair market value at the date of issuance on January 9, 2008. This additional issuance of shares contributed to the increase in goodwill amounting to $477,000.

6. ACCRUED EXPENSES

Accrued expenses comprises of the following as of September 30, 2008 and December 31, 2007.

(in thousands of US Dollars):	September 30, 2008 (Unaudited)	December 31, 2007
Professional fee	$ 621	$ 480
Director fee	103	111
Salaries and benefit payable	121	1,042
Marketing expense	477	973
Income tax payable	6	3
Others	1,909	793
Total	$ 3,237	$ 3,402

7. STOCKHOLDERS' EQUITY

a) COMMON STOCK

For the Nine months period ended September 30, 2008, the Company had the following equity transactions:

(i) 2,036,800 restricted PacificNet shares were issued as settlement of director fees and certain employee compensation fees and executive bonuses, such shares were valued at $1,751,800;
(ii) 10,000 PacificNet shares were repurchased from open market at $1.48 per share;
(iii) 149,459 PacificNet shares were issued to Take 1 from escrow as consideration of 30% of Take 1's equity interests;
(iv) 825,000 PacificNet treasury shares were issued to Shenzhen GuHaiGuangChao's shareholder under a share swap agreement dated March 28, 2008. In exchange for the issuance of the 825,000 PACT treasury shares issued to the shareholder of GHGC, we received 16,860,000 shares of First China Financial Holdings Ltd. ("FirstChina" formerly "IFN", listed on the HK Stock Exchange as 8123.HK) which was issued to PacificNet Strategic Investment Holdings Limited, a wholly owned subsidiary of PacificNet. The Company recorded unrealized loss of $857,000 on the marketable securities as at September 30, 2008 as stipulated per SFAS 115;
(v) 1,350,000 shares were issued to Mutual International Ltd for acquisition purpose. As the acquisition was not materialized, these shares are now held by PacificNet as treasury shares;
(vi) As a result of the failure of the Octavian acquisition to be consummated and the termination of the acquisition agreement, Octavian returned the PacificNet shares issued to it before. These 2,330,000 shares are treated as treasury shares;
(vii) As a result of the settlement with certain bondholders who had filed an involuntary petition seeking Chapter 11 relief in Delaware federal bankruptcy court earlier this year, PacificNet issued 668,321 shares of common stock to the bondholders upon conversion of a portion of the Debentures; besides, in connection with the execution of the Settlement Agreement, PacificNet and the Debenture Holders simultaneously entered into an Escrow Agreement, Pursuant to the terms of the Conversion Shares Escrow Agreement, PacificNet delivered stock certificates representing a total of 9,363,252 shares of common stock of PacificNet to Continental Stock Transfer & Trust Company representing the number of shares of common stock of PacificNet issuable upon full conversion of the debentures, based upon a conversion price equal to the Escrow Conversion Price;
(viii) 60,000 shares were issued to Gu Hao for acquisition purpose;
(ix) 240,000 shares were issued to WONG TSZ YU for acquisition purpose.

b) STOCK OPTION PLAN

Prior to January 1, 2006, PacificNet accounted for awards granted under stock-based compensation plans following the recognition and measurement principles of APB 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, compensation expense was recognized for awards granted at an exercise price less than fair market value of the underlying common stock on the date of grant. Effective January 1, 2006, PacificNet adopted the fair value recognition provisions of SFAS 123(R). See Note 2 for a description of the Company's adoption of SFAS 123R. The fair value of stock options is determined using the Black-Scholes option pricing model, which is consistent with the valuation techniques previously utilized for options in footnote disclosures required under SFAS 123, as amended by FASB Statement No.148, "Accounting for Stock-Based Compensation - Transition and Disclosure." The determination of the fair value of stock-based compensation awards on the date of grant using an option-pricing model is affected by the Company's stock prices as well as assumptions regarding a number of complex and subjective variables, including the expected volatility of the Company's stock price over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The valuation provisions of SFAS 123(R) apply to new grants and unvested grants that were outstanding as of the effective date. For the Nine months ended September 30, 2008, no new options were granted and 1,650 options were vested, thus the option-related compensation cost is $4,545.. PacificNet elected the modified prospective method and therefore has not restated results for prior periods due to 123R.

10

The status of the Stock Option Plan as of September 30, 2008, is as follows:

	OPTIONS OUTSTANDING	WEIGHTED AVERAGE EXERCISE PRICE
OUTSTANDING, DECEMBER 31, 2006	370,500	$ 2.00
Granted	806,000	4.26
Cancelled	(941,500)	2.00
Exercised	(202,000)	2.00
OUTSTANDING, DECEMBER 31, 2007	33,000	4.31
Granted	-	-
Cancelled	-	-
Exercised	-	-
OUTSTANDING, SEPTEMBER 30, 2008	33,000	4.31

Following is a summary of the status of options outstanding at September 30, 2008:

Grant Date	Total Options Outstanding	Aggregate Intrinsic Value	Weighted Average Remaining Life (Years)	Total Weighted Average Exercise Price	Option Exercisable	Weighted Average Exercise Price
2007-8-13	33,000	$ 0	4.87	$ 4.31	-	$ 4.31

PacificNet previously granted 788,000 options on August 11, 2007; however, as most of the optionees did not sign or execute the option agreements before December 31, 2007, most of the options have been forfeited except for 33,000 options. These options vesting commenced from August 8, 2008 with a 5% per quarter vesting schedule, and the corresponding compensation costs will be recorded within the vesting period. The weighted-average fair value of such options was $2.75.The assumptions used in calculating the fair value of options granted using the Black-Scholes option-pricing model are as follows:

Risk-free interest rate	4.51%
Expected life of the options	5.86 years
Expected volatility	67.44%
Expected dividend yield	0%

No other options were granted, exercised, cancelled for the nine months ended September 30, 2008.

1,650 options were vested during the quarter ended September 30, 2008. The option related compensation cost is $4,545.

c) WARRANTS

At September 30, 2008, the Company had outstanding and exercisable warrants to purchase an aggregate of 1,007,138 shares of common stock. The weighted average remaining life is 1.59 years and the weighted average exercise price per share is $10.61 per share.

Following is a summary of the warrant activity:

	Warrants outstanding	WEIGHTED AVERAGE EXERCISE PRICE	Aggregate Intrinsic Value
OUTSTANDING, DECEMBER 31, 2006	1,007,138	$ 10.61	$ -
Granted			
Forfeited			
Exercised			
OUTSTANDING, DECEMBER 31, 2007	1,007,138	$ 10.61	$ -
Granted			
Forfeited			
Exercised			
OUTSTANDING, SEPTEMBER 30 ,2008	1,007,138	$ 10.61	$ -

Following is a summary of the status of warrants outstanding at September 30, 2008:

Grant Date	Total warrants Outstanding	Weighted Average Remaining Life (Years)	Total Weighted Average Exercise Price	Warrants Exercisable	Weighted Average Exercise Price
2004-1-15	123,456	0.29	$ 7.15	123,456	$ 7.15
2004-11-15	117,682	1.13	$ 3.89	117,682	$ 3.89
2004-12-9	350,000	1.19	$ 12.21	350,000	$ 12.21
2006-3-13	416,000	2.45	$ 12.20	416,000	$ 12.20

No warrants were granted, cancelled and exercised during the nine months period ended September 30, 2008.

d) TREASURY STOCK

The following is a summary of the movement of the Company's shares held as treasury stock for the quarter ended September 30, 2008:

	Number of shares	Note
Escrow shares returned to treasury on	800,000	
Repurchase in the open market	50,888	
Repurchase of shares from Take1	149,459	
Cancellation of former employee shares	45,000	
Holdback shares as contingent consideration due to performance targets not yet met	4,209,848	(1)
Incomplete Acquisition of ChinaGoHi (GHGC)	825,000	
Cancellation of acquisition of Allink	200,000	
Repurchase of shares from Yueshen	24,200	
Shares sold to the open market	(41,426)	
Settlement with GHGC & Share Exchange with FirstChina	(825,000)	
Issuance 149,459 shares to Take 1	(149,459)	
Settlement with Convertible debentures holders	9,363,252	
Balance, September 30, 2008	14,651,762	
Shares outstanding at September 30, 2008	15,953,652	
Shares issued at September 30, 2008	30,605,414	

(1) Includes shares related to Clickcom acquisition: 78,000 PacificNet shares; Guangzhou Wanrong acquisition: 138,348 PacificNet shares; iMobile acquisition: 153,500 PacificNet Shares; PacificNet Games Limited (PGL): 160,000 PacificNet shares; Octavian acquisition: 2,330,000 PacificNet shares, and G-lot acquisition: 1,350,000 PacificNet shares.

8. CONVERTIBLE DEBENTURES

8.1 Eight Million Convertible Debentures

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

13

Under the terms of a registration rights agreement entered into at the time of the private placement, the Company was obligated to file a registration statement with respect to the shares issuable under the debenture and the warrants by April 30, 2006, and have the registration statement declared effective by the SEC no later than June 28, 2006. Due to various factors, the Company did not file the registration statement until May 15, 2006, and it was not declared effective until December 8, 2006. Therefore, under the terms of the registration rights agreement, the Company was obligated to pay liquidated damages to the investors at the rate of 2% of the principal amount of the debenture each month beginning on June 28, 2006 until the effectiveness of the registration statement, which was equal to $1,120,000, in the aggregate.

In February 2007, upon reaching an agreement on the amount and payment of accrued liquidated damages, the Company signed a Settlement and Release Agreement with each of the investors. Under the terms of the Settlement and Release Agreements, the Company paid an aggregate $140,000 in cash as satisfaction in full of liquidated damages owed to Basso Fund Ltd., Basso Multi-Strategy Holding Fund Ltd., and Basso Private Opportunities Holding Fund Ltd. Partial liquidated damages owed to Whalehaven Capital Fund Ltd. were paid in the amount of $35,000 in cash, with the remaining liquidated damages in the amount of $105,000 paid in the form of a new convertible debenture due February 2009, on substantially the same terms as the original debentures, except that interest only is paid on the new debentures until October 2008 and beginning in November 2008 until February 2009, when the new debentures are due, the monthly redemption amount under the new debentures shall be equal to $315,000. The remaining investors also agreed to accept the aggregate $840,000 in liquidated damages owed to them in the form of the new convertible debentures for the amount of their respective portion of the liquidated damages. The Company also agreed to amend the original debentures to shorten the term for payment of the original principal amount to a 22 month term. As a result the monthly redemption amount for the original debenture increased from $320,000 to $ 363,638. All other terms and conditions of the original debenture remain in full force and effect.

C.E. Unterberg, Towbin L.L.C. acted as placement agent and received a negotiated cash fee in the amount of $449,500 and a warrant to purchase up to 16,000 shares at an exercise price of $12.20 per share, which expire five years from the date of issuance. The fair value of these warrants totaled $28,141. Such amount was charged to other assets, net, and credited to additional paid-in capital and will be amortized over the life of the debentures. Maxim Group also acted as Placement Agent and received a cash fee in the amount of $50,000.

In connection with the issuance of the debentures, the Company incurred $1,106,135 of issuance costs, which primarily consisted of investment banker fees, legal and other professional fees. These costs have been recorded as additional expense during year 2006.

CHANGE IN ACCOUNTING PRINCIPLE: On January 1, 2007, the Company adopted FSP EITF 00-19-2 and reclassified warranty liability to equity thru cumulative – effect adjustment to the opening balance of retained earnings/loss by $213,000.

The FSP states that for registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of the FSP and that continue to be outstanding at the beginning of the period of adoption, transition shall be achieved by reporting a change in accounting principle through a cumulative effect adjustment to the opening balance of retained earnings, or other appropriate component of equity or net assets in the statement of financial position, in the first interim period of the fiscal year in which this FSP is initially applied. No prior period information is retrospectively adjusted following the transition provisions of FSP.

EVENT OF DEFAULT

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

a) "If, during the Effectiveness Period, either the effectiveness of the Registration Statement lapses for any reason or the Holder shall not be permitted to resell Registrable Securities under the Registration Statement for a period of more than 20 consecutive Trading Days or 60 non-consecutive Trading Days during any 12 month period, the Company has to pay ‘Mandatory Default Amount’ as the sum of (i) the greater of (A) 130% of the outstanding principal amount of this Debenture, plus all accrued and unpaid interest hereon, or (B) the outstanding principal amount of this Debenture, plus all accrued and unpaid interest hereon, divided by the Conversion Price on the date the Mandatory Default Amount is either (a) demanded (if demand or notice is required to create an Event of Default) or otherwise due or (b) paid in full, whichever has a lower Conversion Price, multiplied by the VWAP on the date the Mandatory Default Amount is either (x) demanded or otherwise due or (y) paid in full, whichever has a higher VWAP, and (ii) all other amounts, costs, expenses and liquidated damages due in respect of this Debenture."

b) "If any Event of Default occurs, the outstanding principal amount of this Debenture plus accrued but unpaid interest, liquidated damages and other amounts owing in respect thereof through the date of acceleration, shall become, at the Holder’s selection, immediately due and payable in cash at the Mandatory Default Amount. Commencing 5 days after the occurrence of any Event of Default that results in the eventual acceleration of this Debenture, the interest rate on this Debenture shall accrue at an interest rate equal to the lesser of 18% per annum or the maximum rate permitted under applicable law."

Due to the provisions mentioned above and as per the terms of the Debenture, the Company has reclassified the principal amount of the Debenture of $8,000,000 (remaining balance: $4,512,000) and the principal amount of the new Debenture of $945,000 and the interest accrued thereon to current liabilities.

EVENT OF COMPLAINT AND PETITION

On or about October 3, 2007 Iroquois Master Fund, Ltd. filed a complaint in the Supreme Court of the State of New York against PacificNet Inc., claiming that the Company is in default under the Amended and Restated Convertible Debenture due March 2009 (the Amended Debenture”) in the principal amount of $3,000,000 and the Convertible Debenture due February 2009 (the New Debenture”) in the principal amount of $420,000.

Iroquois Master Fund, Ltd. is seeking damages of $3,253,163.80 in the aggregate, together with any accrued but unpaid interest through the date of judgment. Iroquois Master Fund, Ltd. has also demanded reimbursement of its attorney fees and other costs and expenses incurred together with costs and disbursements of this action.

On or about December 5, 2007, PacificNet filed its response by denying that PacificNet is in default and assert an agreement that would enable it to bring the interest payments up to date by the issuance of stock in the near future.

On March 27, 2008, three holders of PacificNet's Convertible Subordinated Debentures filed an involuntary petition for Chapter 11 relief in federal bankruptcy court late Saturday, March 22, 2008 in Wilmington, DE. The Company has retained counsel to oppose the filing because the petition fails to meet the standard for invoking an involuntary bankruptcy and fails to take into consideration other agreements between the Company and the petitioning creditors. The Company intends to vigorously oppose the petition and move for dismissal of the filing, and if successful will seek damages and attorney fees. Subsequently, PacificNet also received default notice from all but one of the debenture holders including Iroquois Master Fund Ltd., Alpha Capital AG, Whalehaven Capital Fund Limited, DKR Soundshore Oasis Holding Fund Ltd., Basso Fund Ltd., Basso Multi-Strategy Holding Fund Ltd., and Basso Private Opportunities Holding Fund Ltd. from the same Convertible Subordinated Debentures related to the private offering of $8,000,000 principal amount variable debentures consummated on March 13, 2006, and due March 2009.

PacificNet has retained counsel to oppose the above petition. The amount of the debt in question is as follows: Iroquois Master Fund Ltd. $2.5 million, Whalehaven Capital Fund Limited $958,000, Alpha Capital AG $685,000 DKR Soundshore Oasis Holding Fund Ltd $960,000, and Basso Fund Ltd., Basso Multi- Strategy Holding Fund Ltd., and Basso Private Opportunities Holding Fund Ltd., a combined amount of $500,000.

EVENT OF SETTLEMENT

On August 29, 2008, PacificNet entered into a Settlement Agreement with certain bondholders who had filed an involuntary petition seeking Chapter 11 relief in Delaware federal bankruptcy court. Pursuant to the terms of the Settlement Agreement, the Company has amended and restated the terms of certain convertible debentures in the aggregate principal amount of approximately $6.2 million (the "Debentures"). Upon entering into the Settlement Agreement, the Company paid $150,000 of the obligations under the Debentures in cash and issued 668,322 shares of common stock to the bondholders upon conversion of a portion of the Debentures. The remaining outstanding Debentures in the aggregate principal amount of approximately $5.5 million are convertible at a conversion price of $2.00 per share, subject to the terms and conditions of the Debentures.

The Settlement Agreement provides that the Company shall make ten (10) monthly payments under the Debentures and also apply sums due under certain receivables toward payment. All obligations of the Company to the bondholders under the Debentures are due on or before July 15, 2009. Additionally, pursuant to the terms of the Settlement Agreement, the bondholders have received a security interest and collateral assignment in receivables of the Company and certain of its subsidiaries.

Additionally, the Company has issued to the bondholders new debentures representing additional amounts owed to them, which will be due in the event that the Company does not comply with the terms of the Debentures. The parties have further agreed that the bankruptcy action and all related pending litigation will be dismissed without prejudice immediately.

As of September 30, 2008, PacificNet has paid $150,000 of the obligations under the Debentures in cash and issued 668,321 shares of common stock to the bondholders upon conversion of a portion of the Debentures. Following is the summary of convertible debenture as of September 30, 2008:

($,000)	$8 million convertible debenture	$945,000 convertible debenture	Total (Unaudited)
Balance December 31, 2007	$ 4,864	$ 945	$ 5,809
Principal payment:			
Cash payment	150		150
Stock payment	501		501
Accrued interest	299	58	357
Balance September 30, 2008	$ 4,512	$ 1,003	$ 5,515

8.2 Repossession of PacificNet Games Limited (PGL) Due To Default Notice by Pope: Five Million Convertible Note

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

The $5 million convertible secured note issued to Pope matures on February 6, 2010. Subject to reaching certain net income milestones during fiscal year 2007, the note is convertible into an equity interest of PacificNet Games Limited (PGL) ranging between 26% and 32%. The interest rate of the convertible note has initially been set at 8%, and shall increase to 15% if the note is not converted prior to maturity. In connection with the issuance of the note, PacificNet Games Limited (PGL) incurred financing cost of $369,000 which primarily consisted of investment banker fees, legal and other professional fees. These costs have been capitalized and will be amortized over three years, the life of the note.

EVENT OF DEFAULT

Pope Asset Management LLC ("Pope") has sent PacificNet Games Limited (PGL) a default notice on September 17, 2008, alleging that PacificNet Games Limited (PGL) has breached the covenants and representations and warranties of the Loan Agreement and the Stock Pledge Agreement signed between Pacificnet Games Limited (PGL) and Pope dated February 2007. The Company disagrees with Pope on the timing and the reasons of the Defalult Notice that PGL has breached the Loan Agreement.

Although the Company and its Board disagrees with Pope's allegations of any such breaches, and if necessary will defend itself against any such allegations, the Company's Board has approved a release and transfer of the shares of PacificNet Games Limited (PGL) owned by the Company through its wholly-owned subsidiary, to Pope. The escrow agent is in possession of the escrow shares, and the Company is working with the escrow agent to transfer the escrow shares in PGL to Pope. Such escrow shares have not been released but since such release has been approved, the rights to the shares, including voting rights have been vested with Pope.

9. SEGMENT INFORMATION

SFAS No. 131 "DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION.", establishes standards for reporting information about operating segments and for related disclosures about products, services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision-maker, or decision-making group, in making decisions regarding allocation of resources and assessing performance. PacificNet's chief decision-makers, as defined under SFAS 131, are the Chief Executive Officer and Chairman. During 2008 and 2007, PacificNet had four operating segments.

The Company's reportable segments are operating units, which represent the operations of the Company's significant business operations. Summarized financial information concerning the Company's reportable segments is shown in the following table. The "Other" column includes the Company's other insignificant services and corporate related items, and, as it relates to segment profit (loss), income and expense not allocated to reportable segments.

	Nine Month Period Ended	
Revenue from un related entities (In thousands of US Dollars)	September 30, 2008 (Unaudited)	September 30, 2007 (Unaudited)
Group 1 (Outsourcing)	1,875	1,575
Group 2 (Telecom/Value added service)	870	1,261
Group 3 (Products)	12,200	12,268
Group 4 (Other Business)	122	211
Total	15,067	15,315

Income (loss) from operations (In thousands of US Dollars)	Nine Month Period Ended September 30, 2008 (Unaudited)	September 30, 2007 (Unaudited)
Group 1 (Outsourcing)	(372)	(106)
Group 2 (Telecom/Value added service)	(123)	453
Group 3 (Products)	(450)	1,428
Group 4 (Other Business)	(2,380)	(1,791)
Total	(3,325)	(16)

Income tax benefit (expense) (In thousands of US Dollars)	Nine Month Period Ended September 30, 2008 (Unaudited)	September 30, 2007 (Unaudited)
Group 1 (Outsourcing)	-	-
Group 2 (Telecom/Value added service)	3	-
Group 3 (Products)	-	-
Group 4 (Other Business)	-	-
Total	3	-

Net Income (Loss) (In thousands of US Dollars)	Nine Month Period Ended September 30, 2008 (Unaudited)	September 30, 2007 (Unaudited)
Group 1 (Outsourcing)	(195)	(140)
Group 2 (Telecom/Value added service)	(60)	673
Group 3 (Products)	(1,491)	2,545
Group 4 (Other Business)	(2,658)	(3,717)
Total	(4,404)	(639)

Depreciation and amortization (In thousands of US Dollars)	Nine Month Period Ended September 30, 2008 (Unaudited)	September 30, 2007 (Unaudited)
Group 1 (Outsourcing)	5	4
Group 2 (Telecom/Value added service)	170	93
Group 3 (Products)	12	89
Group 4 (Other Business)	122	135
Total	309	321

Total Assets (In thousands of US Dollars)	September 30, 2008 (Unaudited)	December 31, 2007
Group 1 (Outsourcing)	1,235	990
Group 2 (Telecom/Value added service)	1,957	383
Group 3 (Products)	9,731	9,755
Group 4 (Other Business)	6,660	11,933
Total	19,583	23,061

The Company identifies and classifies its operating segments based on reporting entities that exhibit similar long-term financial performance based on the nature of the products and services with similar economic characteristics such as margins, business practices and target market. The operating segments are classified into four major segments which are summarized as follows:

(1) Outsourcing Services - involves human voice services such as Business Process Outsourcing, CRM, call center, IT Outsourcing and software development services. These types of services are conducted through our subsidiaries Smartime/Soluteck.

(2) Telecom Value-Added Services (VAS) - Our subsidiary, Guangzhou Wanrong Information Technology Co., Ltd. ("Guangzhou Wanrong"), is one of the leading value-added telecom service providers in China. Since its inception in 2003, Guangzhou Wanrong has achieved strong growth in its VAS including SMS, WAP, JAVA, MMS, IVR, multimedia entertainment download services, media interactive products, mobile email services, life, sports, entertainment, and business information services.

(3) Product (Telecom & Gaming) Services Group - involves communication and gaming products, GSM/CDMA/3G Products, Multimedia Communication Kiosks. This Group includes the following subsidiaries: PacificNet Communications Limited (PacCom), iMobile and Take1. Take1 Technologies (Take 1), is in the business of designing and manufacturing electronic multimedia entertainment kiosks, coin-op kiosks and machines, Electronic Gaming Machines (EGM), bingo and slot machines, AWP (Amusements With Prizes) games, server-based downloadable games systems, and Video Lottery Terminals (VLT) such as Keno and Bingo machines, including hardware, software, and cabinets.

(4) Other Business -other administrative, financial and investment services and non-core businesses.

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

For the three months ended September 30, 2008	Hong Kong, Macau	PRC	United States	Total
Product revenues	104	4,544		4,648
Service revenues	3	997		1,000

For the three months ended September 30, 2008	Hong Kong, Macau	PRC	United States	Total
Product revenues	1,776	2,573	(21)	4,328
Service revenues	37	889		926

For the three months ended September 30, 2008	Hong Kong, Macau	PRC	United States	Total
Product revenues	1,199	11,001		12,200
Service revenues	41	2,826		2,867

For the three months ended September 30, 2008	Hong Kong, Macau	PRC	United States	Total
Product revenues	6,759	5,508	(21)	12,246
Service revenues	178	2,890		3,068

10. RELATED PARTY TRANSACTIONS

LOAN DUE TO AND FROM RELATED PARTIES

As of September 30, 2008, there was a total loan receivable of approximately $2,326,000 while the loan due to related party was zero.

As at the year ended December 31, 2007, there was a total loan receivable of approximately $2,273,000 due from related parties while the loan due to related party was zero.

As of September 30, 2008 the related party loans receivable included $630,000 due from Pacificnet Power Limited (PactPower), $771,000 due from MOABC, $594,000 due from Linkhead, $2,000 due from Clickcom, $150,000 due from PacSo-HK, and $179,000 due from shareholders and directors of certain of the Company's subsidiaries in connection with the acquisition of these subsidiaries. The loans receivable from shareholders and directors of these subsidiaries are comprised of $115,000 due from a shareholder of Victor Choi and $64,000 due from a director of Soluteck.

As of December 31, 2007 the related party loans receivable included $781,000 due from Pacificnet Power Limited (PactPower), $523,000 due from MOABC, $625,000 due from PACT Linkhead, $15,000 due form PACT AD, $150,000 due from PACT Solution, and $179,000 due from shareholders and directors of certain of the Company's subsidiaries in connection with the acquisition of these subsidiaries. The loans receivable from shareholders and directors of these subsidiaries are comprised of $115,000 due from a shareholder of Victor Choi and $64,000 due from a director of Soluteck.

The terms of these related parties loan receivables and payables are summarized below:

LOAN TO PACIFICNET POWER LIMITED (PactPower)

A convertible loan of $630,000 is outstanding from PactPower. The maturity date of loan was September 9, 2007. Within ninety (90) days overdue, an additional interest charge of 5% per annum will be levied as a penalty. The loan is currently due on demand, non-interest bearing and unsecured.

LOAN TO MOABC

A convertible loan of $771,000 is outstanding from MOABC as of September 30, 2008. The maturity date of loan is January 1, 2009.

LOAN TO LINKHEAD

Linkhead is an affiliated company, 15% owned by PacificNet, as of September 30, 2008. A convertible loan of $594,000 is outstanding from Linkhead. The maturity date of loan was January 1, 2008. The loan is currently due on demand, non-interest bearing and unsecured.

LOAN TO CLICKCOM

A convertible loan of $2,000 is outstanding from Clickcom as at September 30, 2008.

LOAN TO PACIFICNET SOLUTION LIMITED (PactSo-HK)

A convertible loan of $150,000 is outstanding from PactSo-HK. The maturity date of loan was January 6 2007. The loan is currently due on demand, non-interest bearing and unsecured.

LOAN TO VICTOR CHOI SHAREHOLDER

As of September 30, 2008, there was a loan outstanding of $115,000 receivable from the shareholder of Victor Choi. This loan is secured by 30,000 PacificNet shares. The loan is currently due on demand and non-interest bearing.

LOAN TO SOLUTECK'S DIRECTOR

As of September 30, 2008, there was a loan outstanding of $64,000 receivable from a director of Soluteck. The interest rate for the loan is 8% per annum plus 5% penalty interest in case it has not been timely paid. The loan is collateralized with 100,000 PacificNet's shares owned by the borrowing director and Ms Iris Lo, and the remaining assets of Smartime Holding Ltd. The maturity date of loan was January 31 2007. The loan is currently due on demand, non-interest bearing and unsecured.

11. COMMITMENTS AND CONTINGENCIES

OPERATING LEASES - The Company leases warehouse and office space under operating leases with fixed monthly rentals. None of the leases included contingent rentals. Operating lease expense charged to operations for 2008 Q3 amounted to $277,000 (2007 Q3: $120,000). Future minimum lease payments under non-cancelable operating leases are $192,000 for the period from October 2008 to September 2009 and $85,000 for the period from October 2009 to September 2012.

BANK LOANS- Bank loans represent the following at September 30, 2008 (in thousands)

	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)
Unsecured	1,840	1,823
Less: current portion	90	80
Non current portion	$ 1,750	$ 1,743

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

(US$000s)	October 2008 to September 2009	October 2009 to September 2010	October 2010 to September 2011	October 2011 to September 2012	October 2012 to September 2013	Thereafter	TOTAL
Beijing PACT office mortgage (1)	63	66	70	74	78	750	1102
Shenzhen PACT office mortgage (2)	27	29	31	32	35	584	737
TOTAL	90	95	101	107	113	1,334	1,840

(1) Fixed mortgages expiring in 2012 at interest rate of 5.5% per annum.
(2) Fixed mortgage expiring in 2012 at interest rate of 6.2% per annum.

STATUS OF ACQUISITION OF OCTAVIAN INTERNATIONAL LIMITED ("OCTAVIAN")

On January 22 2008, the Company announced the acquisition of Octavian International Limited (“Octavian”), a worldwide supplier of gaming technology, solutions and systems. The Company had previously reported on a Form 8-K filed with the Securities and Exchange Commission on December 13, 2007, the execution of definitive agreements, including that certain Agreement among, PacificNet Games International Corporation (PGIC), Octavian, Emperor Holdings Limited, Ziria Enterprises Limited and the Company on December 7, 2007, for the acquisition of 100% of Octavian (the “Agreement”). PacificNet, through its wholly-owned subsidiary, Pacificnet Games International Corporation, signed an agreement to acquire from Ziria Enterprises Limited, a company incorporated in Cyprus (the “Seller”), 100% of the issued and outstanding shares (the “Shares”) of Emperor Holdings Limited, a company incorporated in Cyprus (the “Holding Company”), which is the parent company of Octavian.

Up to April 14, 2008, Ziria Enterprises Limited did not deliver to PacificNet the share certificates of Emperor Holdings Limited, the legal owner of Octavian International Limited. As a result of Ziria’s failure to deliver the share certificates, which was a condition to closing the acquisition of Octavian, on May 21, 2008, the Company, Ziria, PacificNet Games International Corporation, Octavian and Emperor Holdings Limited terminated the agreement to acquire Octavian. Under the acquisition agreement, if the transaction had been consummated, PacificNet was obligated to issue, in the aggregate, 2,330,000 restricted shares of PACT representing approximately 19.5% of PacificNet's outstanding shares and cash of up to $18,900,000, which would have been paid upon the completion of certain net profit performance targets.

All parties involved have agreed not to complete the merger but will remain distribution partners of complimentary products in each others respective markets.

As a result of the failure of the Octavian acquisition to be consummated and the termination of the acquisition agreement, on May 21, 2008, Mr. Harmen Brenninkmeijer, Chief Executive Officer of Octavian, resigned as a member of the Board of Directors of PacificNet. It was a condition to the closing of the acquisition of Octavian that Mr. Brenninkmeijer was appointed to the Board of Directors. There was no disagreement between Mr. Brenninkmeijer and PacificNet on any matter relating to PacificNet’s operations, policies or practices.

As at December 31, 2007 the 2,330,000 shares were issued and recorded as deposit total amounted to approx. $10,974,000. These shares were received from Octavian as at September 30, 2008 and included under treasury stock.

12. DISCONTINUED OPERATION /NET ASSETS HELD FOR DISPOSITION

Sale of Interest in Guangzhou 3G Information Technology Co., Ltd. ("Guangzhou 3G")

On April 30, 2007, through our wholly-owned subsidiary, PacificNet Strategic Investment Holdings Limited (“PSI Holdings”), we entered into a stock purchase and sale agreement with Heyspace International Limited to sell PSI Holdings’ 51% interest in Guangzhou 3G's parent company, Pacific 3G Information & Technology Co. Limited. The purchase price is $6,000,000 payable in installments over a six month period or earlier if Heyspace completes its initial public offering prior to October 31, 2007. Heyspace paid an initial purchase price of $1,000,000 and the remaining balance to be paid by October 2007. Due to non payment of the remaining balance by Heyspace as per the agreement, the Company on November 25, 2007 entered into a memorandum of understanding (“MOU”) with Heyspace. Pursuant to the MOU, we agreed with Heyspace that for a period commencing on November 25, 2007 through March 31, 2008, we are free to seek new buyers to purchase PSI Holdings’ share ownership in Guangzhou 3G at a consideration and term which at a minimum will not cause any disposal loss to us.

PacificNet and Heyspace entered into a Supplement Agreement for 3G's deal on 20th March, 2008. According to this supplement agreement, PacificNet will apply $500,000 received as of December 31, 2007 against the 5% ownership interest and the remaining $500,000 will be served as a collateral along with the transfer of the share certificates of 46% shares to PacificNet from Heyspace. If Heyspace fails to pay the remaining USD$5,000,000 on or before 31 March, 2009, PacificNet has right to reclaim for the unpaid 46% shares of Pacific 3G Information & Technology Co., Limited, and demand for an annual interest rate of 12%. As at September 30, 2008, the company has made $3.5 million provision against the receivable from Heyspace.

Sale of Interest in PacificNet Epro Holdings Limited ("Epro")

On April 18, 2008, PacificNet consummated the sale of the Company's subsidiary, PacificNet Epro Holdings Limited, a company incorporated in the Hong Kong Special Administrative Region of the PRC ("Epro"), which is primarily engaged in the business of providing call center telecom and customer relationship management services as well as other business outsourcing services in China. Pursuant to the terms of the Sales and Purchase Agreement (the "Agreement") entered into between the Company and Epro Group International Limited (the "Epro Group International"), PacificNet sold its entire share ownership of 7,766,993 shares in Epro for HK$21 million. The Company received a payment of HK$3 million upon execution of the Agreement and a payment of HK$4 million on September 30, 2008. PacificNet shall receive the remaining purchase price in installments over the next twenty-four months. Pursuant to the terms of the Agreement, within sixty days of the closing, Epro shall repay PacificNet HK$2 million for an interest bearing loan granted from PacificNet to Epro. The loan has now been fully repaid by Epro in 2 installments, HK$1 million was paid on May 21, 2008 and the balance of HK$1 million was paid on July 7, 2008.

Following is the summary of net assets held for disposition as of April 11, 2008 (In thousands of US dollars):

Assets :-		
Cash and cash equivalents	$	424
Accounts receivable, net		1,398
Other receivable		410
Other current assets		620
Property, Plant & Equipment, net		518
Others		131
Total Assets		3,501
Liabilities :-		
Accounts payable and accrued expense		495
Others		443
Total Liabilities		938

The components of loss from operations related to the entity held for disposal for the year ended April 11, 2008 are shown below (In thousands of US dollars).

Net sales	$	398
Operating expenses		
Selling, general and administrative		284
Depreciation and amortization		38
Total operating expenses		322
Loss from operations		76
Non-operating income (expenses) :-		
Other income		(2)
Interest income		(18)
Net profit before income tax		56
Provision for Income tax		-
Minority interest-PL		2
Net profit from entity held for disposal	$	58

Reposession of PacificNet Games Limited (PGL) Due to Default Notice from Pope Asset Management, LLC (Pope)

Pope Asset Management LLC ("Pope") has sent PacificNet Games Limited (PGL) a default notice on September 17, 2008, alleging that PacificNet Games Limited (PGL) has breached the covenants and representations and warranties of the Loan Agreement and the Stock Pledge Agreement signed between PacificNet Games Limited (PGL) and Pope dated February 2007. The Company disagrees with Pope on the timing and the reasons of the Default Notice that PGL has breached the Loan Agreement.

Although the Company and its Board disagrees with Pope's allegations of any such breaches, and if necessary will defend itself against any such allegations, the Company's Board has approved a release and transfer of the shares of PacificNet Games Limited (PGL) owned by the Company through its wholly-owned subsidiary, to Pope. The escrow agent is in possession of the escrow shares, and the Company is working with the escrow agent to transfer the escrow shares in PGL to Pope. Such escrow shares have not been released but since such release has been approved, the rights to the shares, including voting rights have been vested with Pope.

As of September 30, 2008, PGL was not consolidated and reclassified as held for disposal in the accompanying financial statements.

Following is the summary of net assets held for disposition as of September 30, 2008 (In thousands of US Dollars):

Assets :-		
Cash and cash equivalents	$	115
Accounts receivable, net		735
Inventory		125
Other current assets		110
Other receivable		64
Property, Plant & Equipment, net		440
Intangible assets		75
Others		192
Total Assets		1,856
Liabilities :-		
Accounts payable and accrued expense		149
Convertible debenture - non current portion		2,737
Others		152
Total Liabilities		3,038

The components of loss from operations related to the entity held for disposal for the year ended September 30, 2008 are shown below (In thousands of US Dollars).

Net sales	$	8
Operating expenses		
Selling, general and administrative		1,264
Depreciation and amortization		240
Total operating expenses		1,505
Profit (Loss) from operations		(1,497)
Non-operating income (expenses) :-		
Other income		-
Interest income		(563)
Net profit before income tax		(2,060)
Provision for Income tax		-
Minority interests		1,010
Net profit from entity held for disposal	$	(1,050)

Information relating to the operations of the subsidiaries up to the nine month periods of September 30, 2008 is as follows (in thousands of US Dollars):

(In US$ thousands)		Epro	PactGames (BVI)	Clickcom	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)
Income (loss) from discontinued operations	$	58	(1,050)	-	992	(1,141)
Gain (loss) on disposal	$	(59)	-	(24)	(83)	2,181

27

Receivable in lieu of disposed subsidiary comprised of the following:

(in 000' $)	September 30, 2008	December 31, 2007
Receivable from Epro	$ 1,794	$ -
Receivable from G3G	5,000	5,000
Provision for bad debt	(3,500)	(3,500)
Receivable, net	$ 3,294	$ 1,500

13. INVESTMENTS IN AFFILIATED COMPANIES

Investments

Investments that are recorded at cost are evaluated for any impairment that are not temporary in nature and adjusted for the impairment.

Investments in affiliated companies are consisted of the following as of September 30, 2008:

Under Cost Method:

(USD'000)	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)	DESCRIPTION
Glad Smart	$ -	$ 30	
Linkhead	65	65	15% ownership interest
Clickcom	-	25	
KingLott	168	-	19% ownership interest
Poly Blue	61	-	18% ownership interest
Total	$ 294	$ 120	

Under Equity Method:

Investments accounted for under the equity method are carried at cost and adjusted for the Company's proportionate share of undistributed earnings and losses.

(USD ' 000s)	September 30, 2008 (Unaudited)	December 31, 2007 (Audited)	DESCRIPTION
Bell-Pact Shanghai JV	$ 3	$ 13	40% ownership interest

28

14. ACQUISITION

(1) ACQUISITION OF UNIVERSAL KINGLOTT (BEIJING) TECH CO., LTD.

On August 18, 2008, the Company entered into a purchase agreement to acquire 19% equity interest of a Chinese lottery company called Universal KingLott (Beijing) Tech Co., Ltd...We paid entirely with shares of 240,000 PacificNet Shares, valued at $0.58 per share on Sep 16, 2008.

(2) ACQUISITION OF GUANGDONG POLY BLUE EXPRESS COMMUNICATIONS CO., LTD

On September 01, 2008, the Company entered into a purchase agreement to acquire 18% equity interest of Guangdong Poly Blue Express Communications Co.,Ltd.. We paid entirely with shares of 60,000 PacificNet Shares, valued at $0.80 per share on Sep 4, 2008.

15. LEGAL PROCEEDINGS

1. Johnson Controls Hong Kong Limited (JCHKL) vs. PacificNet Power Limited (PactPower)

On January 19, 2007, Johnson Controls Hong Kong Limited filed a civil claim against PacificNet Power Limited (a 15% owned subsidiary of PacificNet) in the High Court of the Hong Kong Special Administrative Region seeking HK$4,800,000 as payment for services rendered to replace 3 sets of rain water-cooled chillers, together with energy saving performance (the "Chiller System"), at the Fortress Tower in Hong Kong.

In connection with the claim, PacificNet Power reviewed a letter from its client, China Weal Property Management Ltd., dated January 22, 2007 stating that the construction work by JCHKL had not been completed as of the date of the letter, and that certain violations itemized in a letter issued by the Hong Kong Environment Protection Department (EPD) (Noise Abatement Notice No. N806030) addressed to JCHKL with respect to acoustic problems with JCHKL’s equipment had not been abated.

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

On February 13, 2007, the board instructed the Hong Kong legal counsel to issue a Defense and Counterclaim to JCHKL to counter-claim that (i) JCHKL's construction work has not complied with the applicable rules and regulations of various government authorities in Hong Kong; (ii) the Chiller System provided by JCHKL was defective and merchantable unfit and JCHKL has failed and/or refused to rectify such defective works; and (iii) JCHKL shall return the work deposit in the amount of HK$1,500,000 to PacificNet Power Limited and shall compensate and keep PacificNet Power Limited indemnified against all the loss and damages suffered as a result of any claims from the China Weal Property Management Ltd..

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

2. PacificNet Power Limited (PactPower) vs Johnson Controls Hong Kong Limited (JCHKL)

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

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

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

On April 23, 2007, PacificNet Power instructed the Hong Kong lawyers to issue a letter to the Defendant requesting and demanding them, being the sub-contractor of the Construction and Replacement Works Contract, to take immediate rectification action within seven days from the date of the said letter to (i) rectify and complete all outstanding defective works of the Construction and Replacement Works Contract; (ii) replace the water-cooled chiller plant and/or equipments which are not conformed with the requirements of the tender documents previously submitted by the Defendant to the Employer; and (iii) improve the poor performance of energy saving of the new water-cooled chiller plant.

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

On July 25, 2007, JCHKL issued a Defense and Counterclaim to PacificNet Power to argue that: (i) they had carried out the works according to the Contract terms; (ii) the works had been approved by PKL Consultants Limited, the consultant representative of the Employer; and (iii) a sum of HK$30,000 is still due and owing by PacificNet Power to JCHKL.

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

3. PacificNet Inc. vs. HLB Hodgson Impey Cheng (HLB or Defendant), a firm of Chartered Accountants and Certified Public Accountants in Hong Kong

On September 20, 2007, PacificNet Inc. filed a claim against its former auditors HLB Hodgson Impey Cheng (HLB), a firm of Chartered Accountants and Certified Public Accountants, in the High Court of the Hong Kong Special Administrative Region seeking refund of the professional fees, compensation of professional fees and expenses for Company to engage and deploy new auditors to take over the incomplete audit works from the Defendant and returning and/or providing all relevant accounting records, vouchers, audit program and working papers retained by the Defendant and losses and damages incurred.

The case is still in the pleadings stage (i.e. filing and serving of Statement of Claim, Defense and/or Counterclaim and Reply) without any update.

4. Iroquois Master Fund, Ltd. vs. Pacificnet Inc.

On or about October 3, 2007 Iroquois Master Fund, Ltd. filed a complaint in the Supreme Court of the State of New York against PacificNet Inc., (Company) claiming that the Company is in default under the Amended and Restated Convertible Debenture due March 2009 (the Amended Debenture") in the principal amount of $3,000,000 and the Convertible Debenture due February 2009 (the New Debenture") in the principal amount of $420,000.

As of August 29, 2008, Company entered into a Settlement and Release Agreement (the "Settlement Agreement") relating to all outstanding disputes and litigation with each of the holders of its debentures, Iroquois Master Fund, Ltd., C.E. Unterberg, Towbin Capital Partners I (n/k/a Collins Stewart), Alpha Capital AG, Whalehaven Capital Fund Ltd., DKR Soundshore Oasis Holding Fund, Ltd., Basso Fund Ltd., Basso Multi-Strategy Holding Fund Ltd., and Basso Private Opportunities Holding Fund Ltd. (collectively the "Debenture Holders").

Pursuant to the terms of the Settlement Agreement, the Company has amended and restated the terms of certain convertible debentures in the aggregate principal amount of approximately $6.2 million (the "Debentures"). Upon entering into the Settlement Agreement, the Company paid $150,000 of the obligations under the Debentures in cash and issued 668,322 shares of common stock to the Debenture Holders upon conversion of a portion of the Debentures. The remaining outstanding Debentures in the aggregate principal amount of approximately $5.5 million are convertible at a conversion price of $2.00 per share, subject to the terms and conditions of the Debentures.

The Settlement Agreement provides that the Company shall make ten (10) monthly payments under the Debentures and also apply sums due under certain receivables toward payment. All obligations of the Company to the Debentures Holders under the Debentures are due on or before July 15, 2009. Additionally, pursuant to the terms of the Settlement Agreement, the Debentures Holders have received a security interest and collateral assignment in receivables of the Company and certain of its subsidiaries.

Additionally, the Company has issued to the Debentures Holders new debentures representing additional amounts owed to them, which will be due in the event that the Company does not comply with the terms of the Debentures. The parties have further agreed that the bankruptcy action and all related pending litigation will be dismissed without prejudice immediately. On December 15, 2008, provided there are no defaults under the settlement documents, these dismissals would be with prejudice.

16. CURRENT VULNERABILITY DUE TO CERTAIN CONCENTRATIONS

The Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in the PRC, by the general state of the PRC's economy. The Company's business may be influenced by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

The three top customers contributed to sales amounting to $2,700,000, $214,000 and $360,000, the receivable from these customers was $1,346,000, $142,000 and $198,000 respectively as at September 30, 2008. The three top vendors contributed to purchases amounting to $280,000, $201,000 and $185,000, the payable to these vendors was $62,000, $56,000 and $53,000 respectively as at September 30, 2008.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE INFORMATION CONTAINED IN THE FINANCIAL STATEMENTS OF THE COMPANY AND THE NOTES THERETO APPEARING ELSEWHERE HEREIN AND IN CONJUNCTION WITH THE MANAGEMENT'S DISCUSSION AND ANALYSIS SET FORTH IN THE COMPANY'S ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2007, AS AMENDED.

PRELIMINARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained in this Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These include statements about the Company's expectations, beliefs, intentions or strategies for the future, which are indicated by words or phrases such as "anticipate," "expect," "intend," "plan," "will," "the Company believes," "management believes" and similar words or phrases. The forward-looking statements are based on the Company's current expectations and are subject to certain risks, uncertainties and assumptions, including those set forth in the discussion under "Description of Business," including the "Risk Factors" described in that section, and "Management's Discussion and Analysis or Plan of Operation." The Company's actual results could differ materially from results anticipated in these forward-looking statements. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements.

FACTORS THAT COULD AFFECT FUTURE RESULTS

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

The impact of competitive products;
Changes in laws and regulations;
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 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.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis or plan of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an on-going basis, we evaluate our estimates, including those related to accounts receivable reserves, provisions for impairment losses of affiliated companies and other intangible assets, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management believes the following critical accounting policies reflect our more significant estimates and assumptions used in the preparation of our consolidated financial statements:

Allowance for Doubtful Accounts

We evaluate the collect-ability of our trade receivables based on a combination of factors. We regularly analyze our significant customer accounts, and, when we become aware of a specific customer's inability to meet its financial obligations to us, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position, we record a specific reserve for bad debt to reduce the related receivable to the amount we reasonably believe is collectible. We also record reserves for bad debt for all other customers based on a variety of factors including the length of time the receivables are past due, the financial health of the customer, macroeconomic considerations and historical experience. If circumstances related to specific customers change, our estimates of the recoverability of receivables could be further adjusted. In the event that our trade receivables become uncollectible, we would be forced to record additional adjustments to receivables to reflect the amounts at net realizable value. The accounting effect of this entry would be a charge to earnings, thereby reducing our net earnings. Although we consider the likelihood of this occurrence to be remote based on past history and the current status of our accounts, there is a possibility of this occurrence.

In the beginning of the third quarter of 2006, the Chinese government announced that it would implement several new policies regarding mobile phone value-added service providers effective from July 10, 2006. These policies include a “double confirmation” policy and the requirement that value-added service providers provide one-month trial subscriptions. By requiring that mobile phone customers “double-confirm” their intention to purchase services, and by requiring free subscriptions, these policies have negatively affected value-added service providers.

Inventory

Our inventory purchases and commitments are made in order to build inventory to meet forecasted demand for our products. We perform a detailed assessment of inventory for each period, which includes a review of, among other factors, demand requirements, product life cycle and development plans, component cost trends, product pricing and quality issues. Based on this analysis, we record adjustments to inventory for excess, obsolescence or impairment, when appropriate, to reflect inventory at net realizable value. Revisions to our inventory adjustments may be required if actual demand, component costs or product life cycles differ from our estimates. In the event we were unable to sell our products, the demand for our products diminished, and/or other competitors offered similar or better products, we would be forced to record an adjustment to inventory for impairment or obsolescence to reflect inventory at net realizable value. The accounting effect of this entry would be a charge to earnings, thereby reducing our net earnings.

Income Taxes

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We have considered future market growth, forecasted earnings, future taxable income, and the mix of earnings in the jurisdictions in which we operate and prudent and feasible tax planning strategies in determining the need for a valuation allowance. We currently have recorded a full valuation allowance against net deferred tax assets as we currently believe it is more likely than not that the deferred tax assets will not be realized. In the event we determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to earnings in the period such determination is made. Likewise, if we later determine that it is more likely than not that the net deferred tax assets would be realized, the previously provided valuation allowance would be reversed

Contingencies

We may be subject to certain asserted and unasserted claims encountered in the normal course of business. It is our belief that the resolution of these matters will not have a material adverse effect on our financial position or results of operations, however, we cannot provide assurance that damages that result in a material adverse effect on our financial position or results of operations will not be imposed in these matters. We account for contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated.

Valuation of Long-Lived Assets Including Goodwill and Purchased Intangible Assets

We review property, plant and equipment, goodwill and purchased intangible assets for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Our asset impairment review assesses the fair value of the assets based on the future cash flows the assets are expected to generate. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset plus net proceeds expected from disposition of the asset (if any) are less than the carrying value of the asset. This approach uses our estimates of future market growth, forecasted revenue and costs, expected periods the assets will be utilized and appropriate discount rates. Such evaluations of impairment of long-lived assets including goodwill arising on a business combination and purchased intangible assets are an integral part of, but not limited to, our strategic reviews of our business and operations performed in conjunction with restructuring actions. When 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 is identified. The accounting effect of an impairment loss would be a charge to earnings, thereby reducing our net earnings.

Convertible debt

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

The fair value of these derivative instruments, as determined by applying the Black-Scholes valuation model, is adjusted quarterly. The Black-Scholes valuation model requires the input of highly subjective assumptions, including the expected stock price volatility. Additionally, although the Black-Scholes model meets the requirements of SFAS 133, the fair values generated by the model may not be indicative of the actual fair values as our derivative instruments have characteristics significantly different from traded options. Accordingly, the results obtained could be significantly different if other assumptions were used. The effect of this entry would be a charge to net earnings, thereby either increasing or reducing our net earnings based upon the assumptions used and the results obtained.

NATURE OF THE OPERATIONS OF THE COMPANY

NATURE OF BUSINESS

PacificNet Inc. (referred to herein as "PacificNet" or the "Company") was originally incorporated in the State of Delaware on April 8, 1987. PacificNet is a leading provider of gaming and mobile game technology worldwide with a focus on emerging markets in Asia. PacificNet's gaming products are localized to their specific markets creating an enhanced user experience for players and larger profits for operators. PacificNet's gaming clients include the leading hotels, casinos, and gaming operators in Macau, Europe and elsewhere around the world. PacificNet also maintains legacy subsidiaries in the call center and ecommerce business in China. PacificNet employs about 500 staff in its various subsidiaries with offices in the US, Hong Kong, Macau, China. Through our subsidiaries we provide outsourcing services, value-added telecom services (VAS) and products (telecom and gaming) 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. Our products (telecom and gaming) include gaming technology and communication products distribution. The Company's operations are primarily targeted in Greater China and certain Asian country markets.

PacificNet's Gaming Products:

We offer the following gaming technology products for sale:

Electronic gaming machines (EGM). Our line of electronic gaming machines combine localized Chinese and Asian themes and content, advanced graphics, digital sound effects and music, and secondary bonus games.

- Multi-player Electronic Table Games, eTable Series of Multiplayer Gaming Machines
- Multi-player Electronic Baccarat Machines
- Multi-player Electronic Sicbo Machines
- Multi-player Electronic Roulette Machines
- Multi-player Electronic Fish-Prawn-Crab Machines
- Slot Machines
- Electronic Bingo Machines
- Video Lottery Terminals (VLTs)
- Server-Based Gaming Machines (SBG)
- Amusement With Prices (AWP) Machines
- Online Gaming Software Development
- Client-Server Gaming Systems
- CMM Level 3 Certified Gaming Software Development Center in China
- Cabinet Design and Sales, Parts Sales, OEM Games. We design and sell gaming machine cabinets, replacement parts.

PaificNet’s Major Operating Subsidiaries

Take1 Technologies (http://www.take1technologies.com), is in the business of designing and manufacturing electronic multimedia entertainment kiosks, coin-op kiosks and machines, Electronic Gaming Machines (EGM), bingo and slot machines, Amusements With Prizes(AWP) games, server-based downloadable games systems, and Video Lottery Terminals (VLT) such as Keno and Bingo machines, including hardware, software, client-server systems and cabinets. Take1 is a leading designer, developer and manufacturer of multimedia entertainment and communication kiosk products including photo and video entertainment kiosks, digital camera photo development stations, Multimedia Messaging Services (MMS) and mobile content download stations for mobile phones, and other coin-operated peripherals and consumables. Take1 Technologies is based in Hong Kong and markets and distributes its products around the world including the USA, Canada, Mexico, Europe, China, and Southeast Asia.

* To Be Disposed: PacificNet Communications Limited (referred to herein as "PacCom"), incorporated in Hong Kong, is a wholly owned subsidiary of PacificNet that specializes in the sales and distribution of mobile communication products, accessories, phone cards and mobile SIM cards, and telecom related services in Hong Kong and Greater China.

PacificNet iMobile (Beijing) Technology Co., Ltd ("iMobile") is the leading internet e-commerce distributor of mobile products in China. It provides Internet, email, customer service centers, pre and post-sale services, logistics and Cash On Delivery (COD) services to mobile consumers in China. iMobile's 18900.com e-commerce operations combine online internet services with its offline customer services network comprised of a nationwide chain of logistics and customer service centers covering 21 provinces and 40 major cities in China including Beijing, Shanghai, Chongqing, Tianjin, Chengdu, Dalian, Qingdao, Guangzhou, Shenzhen, Zhuhai, Dongguan, Hangzhou, Suzhou, Ningbo, Wenzhou, Nanjing, Wuhan, Xian, Harbin, Qiqihaer, Hunan and Changsha. iMobile has developed into the largest online mobile phone sales company in China and has partnered with Sina, Netease, China.com, joyo.com, and 263.net on e-commerce cooperation. iMobile's 18900.com operation is the designated Internet distributor for Motorola, Nokia, and NEC's mobile products in China.

37

PACT Gaming Technology Operations

1. Participation games: Company-owned gaming machines that we lease to casino operators based upon any of the following payment methods: (1) a percentage of the net win of the gaming machines, (2) fixed daily fees, or (3) in the case of wide-area progressive gaming machines, a percentage of the amount wagered or a combination of a fixed daily fee and a percentage of the amount wagered.

2. Wide Area Game Network, Community Gaming: Electronically linked gaming machines that are located across multiple casinos within a gaming jurisdiction contribute to and compete for large, system-wide progressive jackpots. They are designed to increase gaming machine play for participating casinos by giving the players the opportunity to win a larger jackpot than on a stand-alone gaming machine.

3. Local Area Progressive Jackpots (LAP) participation games: Electronically linked gaming machines that are located within a single casino to a progressive jackpot for that specific casino.

4. Lottery Products, Video Lottery Terminals, Mobile Lottery Terminals, Online Paperless Lottery Sales Systems: Video gaming machines featured with localized Chinese and Asian themes and contents, advanced graphics, digital sound effects and music and incorporate many of the same features as our other gaming machines.

5. Server-based Gaming: A gaming system in which game content and peripherals are configured, maintained and refreshed over a network that links groups of gaming machines to a remote server that also enables custom configuration by operators and central determination of game outcomes.

Gaming Market Overview on Macau, China

According to Macau government statistics, casinos in Macau raked in more than US$10.3 billion (euro7.11 billion) in gaming revenue in 2007, an increase of 46 percent over the previous year as Las Vegas operators rushed to open luxury resorts targeting China's newly wealthy. Macau, the only place in China where casino gambling is legal, overtook the Las Vegas Strip as the world's top gambling center in 2006. During 2006, the 24 casinos in Macau rang up US$6.95 billion in gaming revenue, while the Strip made US$6.69 billion, regulators in the cities said. Macau, a former Portuguese territory and now a special administration region of China, added four new casinos in 2006 and is now rivaling the entire U.S. state of Nevada in gaming revenue, according to figures posted on the Web site of Macau's Gaming Inspection and Coordination Bureau. Nevada reported gaming revenues of US$12.7 billion (euro8.77 billion) for the year to Nov. 30, 2007, according to the state's Gaming Control Board.

In 2008, PacificNet and its gaming subsidiaries will focus on emerging gaming markets worldwide including Asia, South America and Europe. Specific markets will include the UK, Russia, Ukraine, Italy, Germany, Argentina, Colombia, India, Australia, Cambodia, and most notably, Macau, China. PacificNet has chosen to focus on emerging markets due to their projected growth and low barrier to entry.

RESULTS OF OPERATIONS

REVENUES

Revenues for the three and nine months ended September 30, 2008 amounted to $5,648,000 and $15,067,000 respectively, a year-over-year decline of 7% and 2% as compared to $5,254,000 and $15,314,000 for the same periods of the prior year. The year-over-year decrease in revenues was mainly due to the disposal of major legacy CRM and call center unit. Segmented financial information of the three business operating groups is set out below followed by a brief discussion of each business group.

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007

For The Three Months Ended September 30, 2008 (In thousands of US Dollars)	Group 1 Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3 Products (Telecom & Gaming) ($)	Group 4 Other Business ($)	Total ($)
Revenues	591	369	4,649	39	5,648
Earnings / (Loss) from Operations	(61)	(156)	(105)	(1,400)	(1,722)

For The Three Months Ended September 30, 2007 (In thousands of US Dollars)	Group 1 Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3 Products (Telecom & Gaming) ($)	Group 4 Other Business ($)	Total ($)
Revenues	510	360	4,349	35	5,254
Earnings / (Loss) from Operations	(82)	99	125	(325)	(183)

For The Nine Months Ended September 30, 2008 (In thousands of US Dollars)	Group 1 Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3 Products (Telecom & Gaming) ($)	Group 4 Other Business ($)	Total ($)
Revenues	1,875	870	12,200	122	15,067
Earnings / (Loss) from Operations	(372)	(123)	(450)	(2,380)	(3,325)

For The Nine Months Ended September 30, 2007 (In thousands of US Dollars)	Group 1 Outsourcing Services ($)	Group 2. Telecom Value-Added Services ($)	Group 3 Products (Telecom & Gaming) ($)	Group 4 Other Business ($)	Total ($)
Revenues	1,575	1,261	12,268	211	15,314
Earnings / (Loss) from Operations	(106)	453	1,428	(1,791)	(16)

(1) Outsourcing Services:

Revenues from outsourcing services for the three and nine months ended September 30, 2008 amounted to $591,000 and $1,875,000 respectively as compared to $510,000 and $1,575,000 for the same periods of last year. Outsourcing services revenues for the third quarter this year made up of 10 % of the Company’s total revenues and was mainly derived from the software development, R&D, and project management services.

(2) Telecom Value-added Services (VAS):

Revenues for the three months and nine months ended September 30, 2008 were $369,000 and $870,000 respectively, a year-over-year increase of 3% and (31) % as compared to $360,000 and $1,261,000 for the same periods last year.

(3) Products (Telecom & Gaming):

Revenues for the three and nine months ended September 30, 2008 were $4,649,000 and $12,200,000 respectively, as compared to $4,349,000 and $12,268,000 for the same periods of the prior year. Quarterly products revenues accounted for 82% of the Company's total revenues for the third quarter of FY2008, and mainly derived from mobile phone wholesaling and distribution business.

COST OF REVENUES

Cost of revenues for the three and nine months ended September 30, 2008 were $4,928,000 and $12,508,000 respectively, representing a year-over-year increase of 21% and 2% as compared to $4,075,000 and $11,638,000 for the same periods last year. Cost of revenues as a percentage of the corresponding revenues was approximately 87% and 83% for the three and nine months ended September 30, 2008 respectively as compared to 78% and 76% for the same periods of the prior year.

(1) Outsourcing services:

Cost of revenues from outsourcing services for the three and nine months ended September 30, 2008 were $496,000 and $1,451,000 respectively, a year-over-year increase of 20% and 22% as compared to $416,000 and $1,191,000 for the same periods last year. Increase in cost of revenues was largely due to headcount increase at service staff level.

(2) Telecom Value-added Services (VAS):

Cost of revenues from VAS for the three months and nine months ended September 30, 2008 were $335,000 and $489,000 respectively, a year-over-year increase of 309 % and 40% as compared to the same periods last year.

(3) Products (Telecom & Gaming):

Cost of revenues derived from Products for the three and nine months ended September 30, 2008 were $4,095,000 and $10,531,000 respectively, a year-over-year decrease of 12% and 5% as compared to the same periods last year. Approximately 96% of the cost of revenues related to Products for the third quarter of FY2008 was derived from the sales of mobile phones, and 3% was derived from the sales of electronic gaming machines.

GROSS PROFIT

Gross profit for the three and nine months ended September 30, 2008 was $720,000 and $2,559,000, a year-over-year decrease of 39 % and 30% as compared to $1,179,000 and $3,676,000 for the same periods of the prior year. Gross margin for the three and nine months ended September 30, 2008 was 13% and 17% respectively as compared to 22% and 24% for the same periods last year.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses (SG&A) totaled $2,336,000 and $5,576,000 for the three and nine months ended September 30, 2008 respectively, a year-over-year increase of 88% and 65% as compared to $1,242,000 and $3,371,000 for the same periods of the prior year. SG&A as a percentage of quarterly revenues, however, recorded a quarter-over-quarter increase from 24% to 41%. SG&A for the nine months ended September 30, 2008 was mainly derived from the provisions for bad debts of $1,506,000 against receivables, the stock-based compensation cost of $670,000 and the legal or professional expenses of $507,000. SG&A consist primarily of indirect staff salaries, office rental, insurance, advertising expenditure and traveling cost.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (in thousands, except percentages)	Three months ended September 30 2008 ($)	 2007 ($)	Percentage Change (%)
Remuneration and related expenses	1,255	660	90
Office (majority is rental and utilities)	245	171	43
Travel	87	111	(21)
Entertainment	38	38	0
Professional (legal and consultant)	409	115	255
Audit	11	577	(98)
Selling	180	102	77
Recovery of provisions for doubtful accounts from subsequent collections	(134)	(655)	(80)
Other	245	124	98
Total	2,336	1,242	88

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	Nine months ended September 30 2008	2007	Percentage Change
(in thousands, except percentages)	($)	($)	(%)
Remuneration and related expenses	2,611	2,284	14
Office (majority is rental and utilities)	588	500	18
Travel	286	282	1
Entertainment	119	92	29
Professional (legal and consultant)	649	449	44
Audit	167	689	(76)
Selling	496	226	119
Recovery of provisions for doubtful accounts from subsequent collections	393	(1,389)	(128)
Other	266	237	12
Total	5,576	3,371	65

INCOME (LOSS) FROM OPERATIONS

On a year-over-year basis, Loss from operations amounted to $1,722,000 and $3,325,000 for the three and nine months ended September 30, 2008, as compared to Loss from operations of $183,000 and $16,000 for the same periods of prior year. Operating loss for the nine months was mainly due to the year-over-year increased SG&A expenses amounted to $2,205,000 as the Company created approximately $1.5 million provisions for bad debts against receivables.

INCOME TAXES

Income tax provisions for the nine months ended September 30, 2008 was $3,000 (2007Q3: zero). The provision of income taxes depends on the tax rate and tax exemption. 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. Certain subsidiaries and VIEs are qualified for preferred high technology or software enterprise tax status, and they are subject to preferential tax rate of 15% under PRC Income Tax Rules.

MINORITY INTERESTS

Minority interests for the three and nine months ended September 30, 2008 totaled $171,000 and $326,000 respectively as compared to $3,000 and $(524,000) for the same period of the prior year, representing minority ownership interests in subsidiaries in the Company's consolidated financial statement.

NET INCOME (LOSS)

On a year-over-year basis, Net Loss amounted to $1,939,000 and $4,404,000 respectively for the three and nine months ended September 30, 2008, as compared to $220,000 and $639,000 for the same periods of the prior year. The year-over-year increased Net Loss was mainly due to the disposal of assets and the provisions for bad debts.

CASH

Net cash and cash equivalents at September 30, 2008 were approximately $1.08 million as compared to $1.91 million at December 31, 2007. This was primarily due to the cash flow-out from the purchase of Intellectual Property (IP) assets and Slot Machines., and the payment of Convertible Debenture.

CONTRACTUAL OBLIGATIONS

CONTRACTUAL OBLIGATIONS

Cash resources required to satisfy short and long term Contractual obligations as of September 30, 2008 are tabulated below:

Payments Due by Period

Contractual Obligations (in thousands)	Total		Less than 1 year	1-5 years	After 5 years
Line of credit	$	5	5		
Bank Loans		1,840	90	1,750	
Operating leases		277	192	85	
Total cash contractual obligations	$	2,122	287	1,835	

OFF-BALANCE SHEET ARRANGEMENTS

There were no off-balance sheet guarantees, interest rate swap transactions, foreign currency forward contracts or long term purchase commitments outstanding as of September 30, 2008. Further, the Company had not engaged in any non-exchange trading activities during the third quarter of 2008.

INFLATION

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

43

CURRENCY EXCHANGE FLUCTUATIONS

All of the Company's revenues are denominated either in U.S. dollars or Hong Kong dollars, while its expenses are denominated primarily in Hong Kong dollars and Renminbi ("RMB"), the currency of the People's Republic of China. The value of the RMB-to-U.S. dollar or Hong Kong dollar-to-United States dollar and other currencies may fluctuate and is affected by, among other things, changes in political and economic conditions. Since 1994, the conversion of Renminbi into foreign currencies, including U.S. dollars, has been based on rates set by the People's Bank of China, which are set daily based on the previous day's interbank foreign exchange market rates and current exchange rates on the world financial markets. Since 1994, the official exchange rate generally has been stable. Recently there has been increased political pressure on the Chinese government to decouple the RMB from the United States dollar. Although a devaluation of the Hong Kong dollar or RMB relative to the United States dollar would likely reduce the Company's expenses (as expressed in United States dollars), any material increase in the value of the Hong Kong dollar or RMB relative to the United States dollar would increase the Company's expenses, and could have a material adverse effect on the Company's business, financial condition and results of operations. The Company has never engaged in currency hedging operations and has no present intention to do so.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to various market risks arising from adverse changes in market rates and prices, such as foreign exchange fluctuations and interest rates, which could impact our results of operations and financial position. We do not currently engage in any hedging or other market risk management tools, and we do not enter into derivatives or other financial instruments for trading or speculative purposes.

Foreign Currency Exchange Rate Risk

Fluctuations in the rate of exchange between the U.S. dollar and foreign currencies, primarily the Hong Dollar and the Chinese Renminbi, could adversely affect our financial results. During the quarter ended September 30, 2006, approximately all of our sales are denominated in foreign currencies. We expect that foreign currencies will continue to represent a similarly significant percentage of our sales in the future. Selling, marketing and administrative costs related to these sales are largely denominated in the same respective currency, thereby mitigating our transaction risk exposure. We therefore believe that the risk of a significant impact on our operating income from foreign currency fluctuations is not substantial. However, for sales not denominated in U.S. dollars, if there is an increase in the rate at which a foreign currency is exchanged for U.S. dollars, it will require more of the foreign currency to equal a specified amount of U.S. dollars than before the rate increase. In such cases and if we price our products in the foreign currency, we will receive less in U.S. dollars than we did before the rate increase went into effect. If we price our products in U.S. dollars and competitors price their products in local currency, an increase in the relative strength of the U.S. dollar could result in our price not being competitive in a market where business is transacted in the local currency. All of our sales denominated in foreign currencies are denominated in the Hong Dollar and the Chinese Renminbi. Our principal exchange rate risk therefore exists between the U.S. dollar and these two currencies. Fluctuations from the beginning to the end of any given reporting period result in the re-measurement of our foreign currency-denominated receivables and payables, generating currency transaction gains or losses that impact our non-operating income/expense levels in the respective period and are reported in other (income) expense, net in our combined consolidated financial statements. We do not currently hedge our exposure to foreign currency exchange rate fluctuations. We may, however, hedge such exposure to foreign currency exchange rate fluctuations in the future.

All of our sales denominated in foreign currencies are denominated in the Hong Dollar and the Chinese Renminbi. Our principal exchange rate risk therefore exists between the U.S. dollar and these two currencies. Fluctuations from the beginning to the end of any given reporting period result in the re-measurement of our foreign currency-denominated receivables and payables, generating currency transaction gains or losses that impact our non-operating income/expense levels in the respective period and are reported in other (income) expense, net in our combined consolidated financial statements. We do not currently hedge our exposure to foreign currency exchange rate fluctuations. We may, however, hedge such exposure to foreign currency exchange rate fluctuations in the future.

Interest Rate Risk

Changes in interest rates may affect the interest paid (or earned) and therefore affect our cash flows and results of operations. We are exposed to interest rate change risk with respect to one of our subsidiaries credit facility with a commercial lender. However, we do not believe that this interest rate change risk is significant.

Inflation

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

Currency Exchange Fluctuations

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

Concentration of Credit Risk

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

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

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

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

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

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Seasonality and Quarterly Fluctuations

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

Sales of our gaming machines to Macau and other Asian casinos and gaming operators are generally strongest in Q3 and Q4 and slowest in the Chinese New Year holiday season in Q1. In addition, quarterly revenues and net income may increase when we receive a larger number of approvals for new games from regulators and gaming operators than in other quarters, when a game or platform that achieves significant player appeal is introduced or if gaming is permitted in a significant new jurisdiction. In addition, as further technology advancements become available for the gaming industry, replacement or conversion of gaming machines will be impacted once any such advanced technology is approved by regulators.

ITEM 4T. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

Pursuant to Rule 13a-15 and 15d-15 under the Exchange Act, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of and design and operation of our disclosure controls and procedures as of September 30, 2008. Based on that evaluation, our disclosure controls and procedures were ineffective, as of the end of the period covered by this report, due to the material weakness in our internal control over financial reporting described below.

In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in designing and evaluating the controls and procedures. We regularly review and document our disclosure controls and procedures, and our internal controls over financial reporting, and may from time to time make appropriate changes aimed at enhancing their effectiveness and ensure that our systems evolve with our business.

(b) Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as defined by Exchange Act Rule 13a-15(f) and 15d-15(f). Our management carried out an evaluation with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our internal control over financial reporting as of the end of the period covered by this report. Management used the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control — Integrated Framework (COSO) in conducting its evaluation. Because of its inherent limitations, internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with established policies or procedures may deteriorate.

A material weakness is a control deficiency, or a combination of control deficiencies, that results in a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected. Based on our evaluation described above, management has concluded that our internal control over financial reporting was not effective as of September 30, 2008. Management has determined that (i) our inadequate staffing and supervision and (ii) the significant amount of manual intervention required in our accounting and financial reporting process are material weaknesses in our internal control over financial reporting.

(c) Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during our most recently completed fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Regarding the material weakness described above, we have identified the following changes necessary to improve our internal control over financial reporting. We have recently signed an agreement with MetricStream to install their software programs on our system and they will also assist us in the training of our accounting staff and implementation of the system as well as on-going compliance monitoring. MetricStream is a market leader in enterprise-wide governance, risk, compliance and quality solutions for global corporations. MetricStream solutions are used by leading corporations such as Pfizer, Covidien, NASDAQ, SanDisk, BP, Entergy, Subway, Fairchild Semiconductor, Hitachi and TaylorMade-Adidas Golf in diverse industries such as pharmaceuticals, medical devices, automotive, food, high tech manufacturing, energy and financial services to manage their quality processes, regulatory and industry-mandated compliance and corporate governance initiatives, as well as by over a million compliance professionals worldwide via complianceonline.com portal.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following exhibits are filed as part of this report:

EXHIBIT NUMBER	DESCRIPTION
31.1	Rule 13a-14(a) Certification of Chief Executive Officer (Principal Executive Officer)
31.2	Rule 13a-14(a) Certification of Chief Financial Officer (Principal Financial Officer)
32.1	18 U.S.C. Section 1350 Certifications

SIGNATURES

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

PACIFICNET INC.

Date: November 21, 2008	By:	/s/Victor Tong Victor Tong Chief Executive Officer (Principal Executive Officer)
Date: November 21, 2008	By:	/s/ Phillip Wong Phillip Wong Chief Financial Officer (Principal Financial Officer)