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PACIFICNET INC
Form 10KSB
April 28, 2006

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

FORM 10-KSB

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

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 000-24985

PACIFICNET INC.
(Exact name of small business issuer in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

91-2118007
(I.R.S. Employer
Identification No.)

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: 0086-10-59225000
601 New Bright Building, 11 Sheung Yuet Road, Kowloon Bay, Kowloon, Hong Kong.
(Former Name and Address)

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

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

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

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

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

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

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

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were 13,238,497 shares of the Company's common stock outstanding on March 31, 2006.

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

DOCUMENTS INCORPORATED BY REFERENCE - NONE

TABLE OF CONTENTS

PART I

ITEM 1. DESCRIPTION OF BUSINESS.....	2
ITEM 2. DESCRIPTION OF PROPERTY.....	30
ITEM 3. LEGAL PROCEEDINGS.....	31
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.....	31

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.....	32
ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.....	34
ITEM 7. FINANCIAL STATEMENTS.....	43
ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.....	44
ITEM 8A. CONTROLS AND PROCEDURES.....	44

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT.....	45
ITEM 10. EXECUTIVE COMPENSATION.....	51
ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT....	53
ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.....	54
ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K.....	54
ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.....	56

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

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ITEM 1. DESCRIPTION OF BUSINESS

As used in this report, "we", "us," "our," "Company", "PacificNet" or "PACT" refers to PacificNet Inc., a Delaware corporation.

OVERVIEW

We were incorporated in the state of Delaware in 1987. Our business consists of four groups, all of which operate within the outsourcing and telecommunications industries in Asia, primarily Greater China, which includes the People's Republic of China (PRC), or mainland China, Hong Kong Special Administrative Region (HKSAR), Macau Special Administrative Region, and Taiwan. Through our subsidiaries we invest in and operate companies that provide outsourcing services, value-added telecom services (VAS) and communication products distribution services. Our business process outsourcing (BPO) services include call centers, providing customer relationship management (CRM), and telemarketing services, and our information technology outsourcing (ITO) includes software programming and development. We are value-added resellers and providers of telecom VAS, which comprises interactive voice response (IVR) systems, call center management systems and voice over internet protocol (VOIP), as well as mobile phone VAS, such as short messaging services (SMS) and multimedia messaging services (MMS). Our communication products distribution services include the wholesale and retail sale and distribution of calling cards in China, multimedia interactive self-service kiosk distribution and online mobile phone distribution. We also have a number of subsidiaries that we use primarily for administration, internal control and acquisition purposes. We intend to continue to grow our business by acquiring and managing growing technology and network communications businesses with established products and customers in Asia.

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

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

PacificNet's operations include the following four groups:

- (1) Outsourcing Services: including Business Process Outsourcing (BPO), call center, IT Outsourcing (ITO) and software development services.
- (2) Value-Added Telecom Services (VAS): including Content Providing (CP), Interactive Voice Response (IVR), Platform Providing (PP) and Service Providing (SP).
- (3) Communication Products Distribution Services: including calling

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cards, GSM/ CDMA/ XiaoLingTong products, and multimedia self-service kiosks.

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

2

CORPORATE STRUCTURE

The chart attached herein as Exhibit 99.1, sets forth our corporate and share ownership structure as of the date of this annual report.

We conduct our business operations through the following business units and subsidiaries:

(I) OUTSOURCING SERVICES GROUP

- 1) PACIFICNET EPRO HOLDINGS LIMITED (FORMERLY KNOWN AS: EPRO TELECOM HOLDINGS LIMITED)

PacificNet Epro Holdings Limited (referred to herein as "Epro"), a company incorporated in the Hong Kong Special Administrative Region of the PRC, is engaged in the business of providing call center and customer relationship management (CRM) services, mobile marketing and promotion services, call center training, management and consulting services, call center software, IVR systems, mobile payment and mobile point of sale (POS) solutions, Internet e-commerce and mobile commerce, mobile applications based on short messaging services (SMS), multimedia messaging services (MMS), outsourced telemarketing and customer support services, and other mobile value-added services (VAS). Epro's business serves Hong Kong and the PRC's telecom operators, banks, insurance, and other financial services companies in the PRC. Epro's clients include major telecom operators, banks, insurance and financial services companies in Greater China, such as China Telecom (NYSE: CHA), China Unicom (NYSE: CHU), PCCW (NYSE: PCW), CSL, SmartTone Telecom, Sunday Communications (NASDAQ: SDAY), Hutchison Whampoa Limited (HKSE: 0013.HK), Swire Coca-Cola, Samsung, Dun & Bradstreet, DBS, Dao Heng Insurance, Shenzhen Development Bank, Hong Kong Government Housing Authority and Hong Kong Post.

- 2) PACIFIC SMARTIME SOLUTIONS LIMITED / PACIFIC SOLUTIONS TECHNOLOGY (SHENZHEN) CO. LTD.

Pacific Smartime Solutions Limited (referred to herein as "Smartime") is an IT outsourcing company incorporated in Hong Kong that operates through its China subsidiary Pacific Solutions Technology (Shenzhen) Co. Ltd. (referred to herein as: Soluteck Shenzhen), which is a leading provider of outsourcing services including software development, R&D, and project management services in China. Smartime employs over 280 staff and provides outsourcing services to the leading telecom, banking and financial services companies in China, including Huawei, IBM, Bank of East Asia. In December 2004, Smartime launched a new software development outsourcing center in Shenzhen, located in a Grade A office building, currently occupying two floors (total 26,000 square feet) with the capacity to expand to two additional floors. Each of the two

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floors will have the capacity to house about 200 employees. The new outsourcing development center will serve its existing clients, which includes some of the world's leading telecom and IT companies.

3) PACIFICNET SOLUTIONS LIMITED (Incorporated in Hong Kong)

PacificNet Solutions Ltd. (referred to herein as "PacSo"), incorporated in Hong Kong, is a subsidiary that specializes in systems integration, software application, and e-business solutions services in Hong Kong and Greater China. The scope of PacSo's products and services includes smart card solutions, web based front-end applications and web based connections to backend enterprise planning systems.

3

(II) VALUE-ADDED TELECOM SERVICES (VAS) GROUP

CONTENT PROVIDER COMPANY

CHINAGOHI/LION ZONE (SPECIAL PURPOSE VEHICLE (SPV)), HOLDING COMPANY FOR CHINAGOHI

In December, 2005, we acquired a controlling interest in Shenzhen GuHaiGuanChao Investment Consultant Company Limited ("ChinaGoHi"), a wholly owned foreign enterprise (WFOE) registered in China, through the purchase of a 51% interest of ChinaGoHi's parent, GoHi Holdings Limited (referred to herein as "Lion Zone"), a British Virgin Islands company. Lion Zone is an investment holding company principally engaged in providing investment advisory consulting services and direct response television (DRTV) telemarketing services. Through ChinaGoHi, we provide infomercial marketing services and telemarketing services and financial advisory services in China, including Direct Response Television (DRTV) infomercials through satellite and cable TV broadcasting, web portals, and subscription-based value-added services including Internet email, short message services (SMS), mobile WAP services, and interactive voice response (IVR) services via fixed and mobile phones. ChinaGoHi ("ChinaGoHi", <http://www.ChinaGoHi.cn>) is a leading information content provider of Chinese stock market information, analysis, and investment advisory services via DRTV infomercials through satellite and cable TV broadcasting, IVR, SMS and WAP based mobile value-added services, web portals and subscription based audio-video streaming via the Internet.

PLATFORM PROVIDING COMPANY

BEIJING LINKHEAD TECHNOLOGIES COMPANY LIMITED (Incorporated in the PRC)

Beijing Linkhead Technologies Company Limited, (referred to herein as "Linkhead"), a PRC limited liability corporation, is engaged in the business of providing value-added services (VAS), interactive voice response (IVR) system development and integration, voice Internet portals, computer telephony integration (CTI), VoIP, Internet and mobile application development, telecom customer relationship management (CRM) services for China's telecom operators, telecom related management and consulting services, mobile consumer analytics, mobile data-mining, Internet e-commerce and mobile commerce, mobile applications based on WAP, K-Java, BREW, EMS, short messaging services

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(SMS), multimedia messaging services (MMS), outsourced software development, and other mobile value-added services (VAS) in the PRC. Linkhead's major clients and profit-sharing partners include some of the leading telecom operators such as China Telecom, China Mobile, China Unicom. Linkhead is also channel partner, or a master reseller, of NMS Communications (NASDAQ: NMSS), a leading provider of communications technologies and solutions which enable new enhanced services and efficient networks that help customers grow their profits and revenue.

SERVICE PROVIDER COMPANIES

1) PACIFICNET CLICKCOM LIMITED (INCORPORATED IN THE PRC)

In December 16, 2004, we entered an agreement to acquire a controlling interest in Guangzhou Clickcom Digit-net Science and Technology Ltd ("Clickcom-WOFE") through the purchase of a 51% interest of Clickcom-WOFE's parent company, PacificNet Clickcom Limited, a British Virgin Islands Company ("Clickcom-BVI"). The deal has been completed on March 28, 2005. Clickcom-WOFE conducts its VAS operations with Guangzhou DianXun Company Limited ("Dianxun-DE"), a PRC registered Domestic Enterprise (DE)., through a series of contractual agreements. Under these agreements, the shareholders of Dianxun-DE are required to transfer their ownership in these entities to our subsidiaries when permitted by PRC laws and regulations and all voting rights are assigned to us. Through Clickcom-WOFE, we have also entered into a consulting and services agreements with Dianxun-DE, under which Clickcom-WOFE provides technical services and other services to Dianxun-DE in exchange for all of the net income of Dianxun-DE. In addition, the shareholders of Dianxun-DE have pledged their shares in Dianxun-DE as collateral for non-payment of fees for the services we provide. Through Clickcom-WOFE we provide directly to China's telecom operators a wide variety of wireless Internet services for mobile phones, such as SMS, Wireless Application Protocol (WAP), which allows users to access information instantly via handheld wireless devices and Java mobile applications. The acquisition of Clickcom-WOFE is our first step in entering the VAS service provider market in which we will be able to design our own mobile phone VAS for distribution directly to telecom operators.

4

2) GUANGZHOU 3G INFORMATION TECHNOLOGY CO. LIMITED (Incorporated in the PRC)

In March 2005 we entered an agreement to acquire a controlling interest in Guangzhou 3G Information Technology Co. Ltd. ("Guangzhou3G-WOFE"), a PRC registered wholly owned foreign enterprise (WOFE), through the purchase of a 51% interest in Guangzhou 3G's parent company, Pacific 3G Information & Technology Co. Limited, a British Virgin Islands Company ("Guangzhou3G-BVI"). Guangzhou3G-WOFE conducts its VAS operations with Guangzhou Sunroom Information Industrial Co., Ltd. ("Sunroom-DE"), a PRC registered Domestic Enterprise (DE), through a series of contractual agreements. Under these agreements, the shareholders of Sunroom-DE are required to transfer their ownership in these entities to our subsidiaries when permitted by PRC laws and regulations and all voting rights are assigned to us. Through Guangzhou3G-WOFE, we have

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also entered into a consulting and services agreements with Sunroom-DE, under which Guangzhou3G-WOFE provides technical services and other services to Sunroom-DE in exchange for all of the net income of Sunroom-DE. In addition, the shareholders of Sunroom-DE have pledged their shares in Sunroom DE as collateral for non-payment of fees for the services we provide. Sunroom-DE is one of the largest value-added telecom and information services providers in China with both voice (IVR and call center) and data (SMS, MMS, WAP, JAVA, GPRS) connection to the four major telecom operators in Asia, China Mobile, China Unicom, China Telecom, and China Netcom, covering both mobile and fixed-line networks. Guangzhou 3G-DE also offers a wide variety of IVR and other wireless and fixed-line, value-added telecom services including color ring back tone (CRBT) services, background music (BGM) services, video ICQ (VICQ) mobile instant messaging services, sports and soccer news, weather forecasts, stock prices, jokes, short stories, dramas, songs and mobile karaoke, mobile TV, games, entertainment, as well as community-oriented services, such as chatline and dating services. Mobile and fixed-line phone users can access Guangzhou 3G-DE's IVR services through one of the four major telecom operators' networks. Guangzhou 3G-DE currently employs 280 staff, and has offices in 26 provinces in China including Guangdong, Guangxi, Hubei, Hunan, Jiangsu, Zhejiang, Shanghai, Henan, Anhui, Yunnan, Gansu, Ningxia, Inner Mongolia, Guizhou, Tianjin, Qinghai, Hainan, Heilongjiang, Shanxi, Shandong, Chongqing, Jiangxi, Beijing, Hebei, Liaoning, and Jilin. Guangzhou 3G's market covers all the major regions of China with over 3 million accumulated fee paying customers.

3) GUANGZHOU WANRONG INFORMATION TECHNOLOGY CO., LIMITED (Incorporated in the PRC)

On January 31, 2006, we consummated an agreement to acquire a 51% majority interest in Guangzhou Wanrong Information Technology Co., Ltd. ("Guangzhou Wanrong"), 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. Guangzhou Wanrong was granted nationwide SMS service numbers "2388" for China Mobile and "9928" for China Unicom.

4) IPACT INTERNATIONAL INVESTMENT LIMITED (Incorporated in the BVI)

Our subsidiary, PacificNet Strategic Investment Holdings Limited holds an 80% equity interest in IPACT International Investment Limited ("IPACT"). IPACT is a newly formed business entity in October 2005. Its primary business will be to sign up qualified Voice-VAS and IVR service providers as profit sharing members in China under a unified brand "iPACT". We will provide to qualified VAS-Alliance partners, on a profit sharing basis, all of the hardware, software, application, and content for VAS, including a variety of IVR and other wireless and fixed-line VAS content, including color ring back tone (CRBT) services, background music (BGM) services, VICQ mobile instant messaging services, sports news, weather forecasts, stock market, humor, songs and mobile karaoke, mobile TV, games, entertainment, as well as community-oriented services, such as chatline and dating services. Mobile and fixed-line phone users can access PacificNet's VAS-Alliance services through Guangzhou 3G presence in 26 provinces in China.

5) PACIFICNET AD. LIMITED (Incorporated in Hong Kong)

PacificNet Ad. Limited was incorporated in Hong Kong in December 2005 and 68% of its outstanding equity shares are held by PacificNet

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Limited. Its principle business is advertising and media services.

5

(III) COMMUNICATION PRODUCTS DISTRIBUTION GROUP

1) GUANGZHOU YUESHEN TAIYANG NETWORK TECHNOLOGY CO. LTD. (Incorporated in the PRC)

Guangzhou YueShen TaiYang Network Technology Co. Ltd. (referred to herein as "YueShen"), a PRC registered sino-foreign equity joint venture, is a subsidiary of PacificNet. YueShen is a leading distributor of telecom services including phone cards, mobile SIM cards, prepaid stored-value cards, re-chargeable phone cards, VoIP and IDD calling cards, Internet access cards, and bundled cross-selling insurance cards, travel and hotel reservation cards and customer loyalty membership cards in China. YueShen is a leading top-level distributor for the major telecom operators in China, including China Mobile, China Unicom, China Telecom, China Netcom and China Railcom.

2) PACIFICNET IMOBILE (BEIJING) TECHNOLOGY CO., LIMITED (Incorporated in the PRC)

On February 06, 2006, we entered into an agreement to acquire a 51% majority interest in PacificNet iMobile (Beijing) Technology Co., Ltd ("iMobile"), one of the leading Internet information portal and e-commerce distributors for mobile phone and accessories and mobile related value-added service providers in China. iMobile operates its e-commerce business via two Internet portals, "<http://www.iMobile.com.cn>" and "<http://www.18900.com>" and one WAP portal "[17wap.com](http://www.17wap.com)" for mobile phone browsing. In addition, iMobile's 18900.com operation is the designated Internet distributor for Motorola, Nokia, and NEC's mobile products in China. 18900.com is the leading Internet e-commerce distributor of mobile products in China, and provides Internet, email, customer service centers, pre-sale and post-sale services, logistics and cash-on-delivery (COD) services to mobile related products in China. iMobile's 18900.com e-commerce operations combines both online Internet services with its offline customer services network composed of a nationwide chain of logistic and customer centers covering 22 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, Xi'an, Harbin, Qiqihaer, Hunan and Changsha. iMobile's Internet portal has been one of the top ranked traffic sites and has achieved about 2.3 million registered online users and over 400,000 active users, with 5 million daily page views and 20,000 blog postings per day, which makes iMobile the top ranked site in its category in China. It is expected this acquisition was structured in the same manner as our other acquisitions, with operation and services agreements between Beijing Xing Chang Xin Science and Technology Development Co. Limited Incorporated DE and PacificNet Imobile (Beijing) Technology, Co. Ltd. WOFE.

3) PACIFICNET COMMUNICATIONS LIMITED

PacificNet Communications Limited (referred to herein as "PacCom"),

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incorporated in Hong Kong, is a wholly owned subsidiary of PacificNet that specializes in telecom related services in Hong Kong and Greater China.

4) TAKE1 TECHNOLOGIES GROUP LIMITED ("TAKE1" , FORMERLY KNOWN AS: CHEER ERA LIMITED)

Take1 (<http://www.take1technologies.com/>) 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, payment and delivery stations for mobile phones, and other coin-operated kiosks and kiosk consumables. Take1 markets and distributes its multimedia communication stations around the world including the USA, Canada, Mexico, Europe, Korea, China, India and SE Asia. Take1 is headquartered in Hong Kong with operations in China, Canada, and USA.

6

(IV) OTHER BUSINESS ENTITIES

1) PACIFICNET LIMITED (INCORPORATED IN HONG KONG)

PacificNet Limited is incorporated in Hong Kong as a wholly owned subsidiary of PacificNet Inc. Its primary purpose is to handle the general administrative operations of PacificNet in Hong Kong.

2) PACIFICNET STRATEGIC INVESTMENT HOLDINGS LIMITED (Incorporated in the BVI)

PacificNet Strategic Investment Holdings Limited (referred to herein as "PacInvest"), incorporated in the British Virgin Islands (BVI), is a wholly owned subsidiary of PacificNet that specializes in strategic investment, direct investment, mergers and acquisitions, joint venture development, and other financial and investment services in Hong Kong and Greater China. Its primary purpose is to help PacificNet identify strategic investment opportunities, process deal flow, conduct due diligence, negotiate terms and valuation, monitor investment performance and conduct synergy development, with a focus in Chinese investment opportunities related to PacificNet's business.

3) PACIFICNET POWER LIMITED (Incorporated in Hong Kong)

PacificNet Power Ltd. (referred to herein as "PacPower"), incorporated in Hong Kong, is a subsidiary that specializes in information technology (IT) solutions, systems integration, software application, energy saving and electric power management systems and solutions in Hong Kong and Greater China. PacificNet Power was registered in Hong Kong in January 2005 as a subsidiary of PacificNet Limited with 51% controlling ownership by PacificNet.

4) PERPETUAL GROWTH INVESTMENTS LIMITED (Incorporated in the BVI)

Perpetual Growth Investments Limited incorporated in the British Virgin Islands (BVI), is a wholly owned subsidiary of PacificNet

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Communications Limited.

5) PACIFIC FINANCIAL SERVICES LIMITED (Incorporated in Hong Kong)

Pacific Financial Services Limited incorporated in Hong Kong in November 2005, is a wholly owned subsidiary of PacificNet Inc. Its primary purpose is to provide financial services in Hong Kong.

6) PACIFICNET GAMES LIMITED (Incorporated in the BVI)

PacificNet Games Limited incorporated in the British Virgin Islands (BVI), is a wholly owned subsidiary of PacificNet Strategic Investment Holdings Limited. Its primary purpose is to design and distribute Internet online games and offline gaming machines.

7) PACIFICNET TECHNOLOGY (SHENZHEN) LIMITED (Incorporated in the PRC)

PacificNet Technology (Shenzhen) Limited (referred to herein as "PacSZ") is incorporated in the PRC as a wholly owned foreign enterprise (WOFE), is a wholly owned subsidiary of PacificNet Limited Hong Kong. Its primary purpose is to provide administrative support back-office, IT support and software development services, to support PacificNet's operations in China, and to conduct the general administrative operations of PacificNet in China.

8) PACIFICNET BEIJING LIMITED (Incorporated in the PRC)

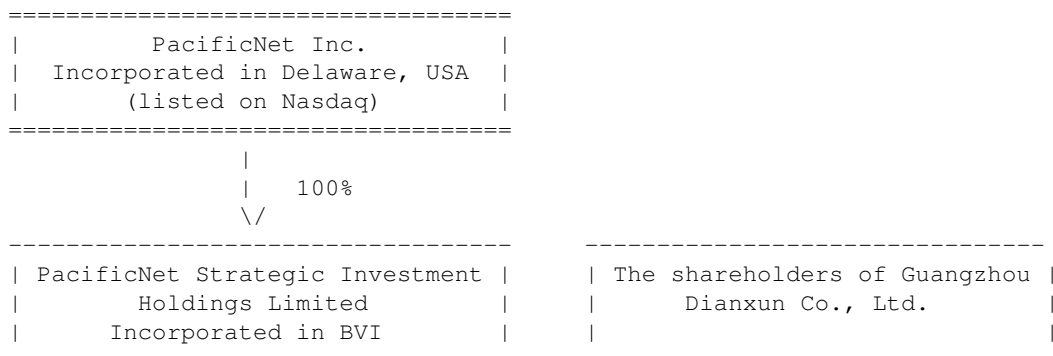
PacificNet Beijing Limited (referred to herein as "PacBJ") incorporated in the PRC as a wholly owned foreign enterprise (WOFE) is a wholly owned subsidiary of PacificNet Limited Hong Kong. Its primary purpose is to provide administrative back-office support, IT support and software development services, to support PacificNet's operations in China, and to conduct the administrative operations of PacificNet in China.

7

OUR ACQUISITION MODEL FOR TELECOM VALUE- ADDED SERVICES COMPANIES IN CHINA

CORPORATE OWNERSHIP STRUCTURE

Set forth below is an illustration of our acquisition model using Clickcom as an example.



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respectively, and their shareholders, and the businesses and operations of the DEs as, respectively, described in this Annual Report, comply with all existing PRC laws, rules and regulations and are fully enforceable in accordance with their terms and conditions. In addition, our internal PRC legal counsel is of the opinion that no consent, approval or license, other than those already obtained, is required under any of the existing PRC laws, rules and regulations for the effectiveness and enforceability of the ownership structures, contractual agreements and businesses and operations of the WOFEs and those DE's. However, there may be uncertainties regarding the interpretation and implementation of current PRC laws and regulations. See "Risk Factors -- Risks Relating to Our Business."

BUSINESS OPERATIONS OF THE WOFES

The business of each of Clickcom, Guangzhou3G, Wanrong and Imobile WOFE's are conducted through a series of contractual agreements with their affiliated PRC-incorporated Domestic Enterprise (DE) value-added service (VAS) or ecommerce providers, Dianxun-DE, Sunroom-DE, Wanrong-DE and Imobile-DE, respectively, and their respective shareholders. We do not have any ownership interests in Dianxun-DE, Sunroom-DE, Wanrong-DE and Imobile-DE.

WIRELESS DATA SERVICES

Dianxun-DE, Sunroom-DE and Wanrong-DE have established cooperation arrangements with mobile telecommunications operators, mobile phone producers and other wireless data service providers in the wireless VAS business. They provide wireless data services through China Mobile's Monternet and China Unicom's UNI-Info platforms pursuant to revenue sharing agreements that they have entered into with these mobile telecommunications operators. These services include color ring back tone (CRBT) services, background music (BGM) services, VICQ mobile instant messaging services, sports and soccer news, weather forecasts, stock prices, jokes, short stories, dramas, songs and mobile karaoke, mobile TV, games and entertainment.

China Mobile and China Unicom control the two mobile telecommunications networks through which all wireless data services are currently provided to mobile phone users in China. Close working relationships with China Mobile and China Unicom are critical to the operation and continued development of wireless data services business. See "Risk Factors -- Risks Relating to Our Business." A substantial portion of Dianxun-DE, Sunroom-DE and Wanrong-DE business depends on mobile telecommunications 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 our revenue. As of the end of 2005, Dianxun-DE, Sunroom-DE and Wanrong-DE had entered into approximately 25 cooperation and revenue sharing agreements with various provincial subsidiaries of China Mobile, as well as China Unicom, to provide wireless data services to mobile phone users, to research and develop new wireless data technologies and to promote the use of wireless data services in China.

Dianxun-DE, Sunroom-DE and Wanrong-DE established the fees for data services in consultation with telecommunications operators in China. They share the revenue from these fees with the telecommunications operators, content providers and mobile phone producers. They also pay a transmission fee to the appropriate telecommunications operator with respect to messages that they send through its value-added services platform.

The mobile telecommunications operators establish standards within which wireless data services providers are able to set the fees for their services. These standards are filed with the Ministry of Information Industry by the mobile telecommunications operators. In accordance with these standards, they charge the users content fees on either a per-message or a monthly subscription

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basis. Both per-message and monthly subscription content fees vary for the different wireless data products and services.

WIRELESS INTERACTIVE VOICE RESPONSE (IVR) SERVICES

In May 2003, China Mobile launched its wireless IVR services nationwide. Mobile phone users access Sunroom-DE's wireless IVR services through China Mobile's network. Sunroom-DE's wireless IVR services include weather forecasts, stock prices, jokes, short stories, dramas, songs and other entertainment topics, as well as community-oriented services, such as chat and dating services.

9

We believe that demand for wireless IVR services in China, like demand for other wireless value-added services, has been driven by the rapid increase in mobile phone ownership, the rise in average income and the emergence of a youth culture that rapidly adopts new modes of affordable entertainment.

CONSULTING AND SERVICE AGREEMENTS

The Consulting and Service Agreement signed between each WOFE and their respective DE is similar. Pursuant to the terms of the agreement, the WOFE ("Party A") agrees to be the exclusive provider of telecom consulting services to the DE ("Party B"). During the term of the agreement, Party B shall not accept technical and consulting services provided by any third party. Party B agrees to pay a fee to Party A equal to 100% of its monthly net income for the services provided. Payment of the service fees has been secured through a share pledge agreement with the shareholders of each of the DEs, whereby they pledged all of their shares to the respective WOFE. In addition, each of the shareholders of the DEs has granted to our President, Mr. Victor Tong, a Power of Attorney which gives him the full power and authority to exercise all of the rights of the shareholders of the DEs.

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

(2) Fees from Service Contracts - Fees from these service contracts are substantial, but are not commensurate with the level of service provided by the WOFEs to the DEs. The contractual and funding arrangements with the DEs evidence that PacificNet has closely participated in the majority of the DEs' economics. PacificNet is the primary beneficiary through its WOFE subsidiaries since PacificNet is the only enterprise with a sufficiently large interest in the VIEs. Accordingly, we conclude that going forward PacificNet should consolidate the DEs' financial interests.

BUSINESS OPERATION HIGHLIGHTS OF 2005

During the three months ended December 31, 2005, we continued to win business from high-profile Chinese and multinational companies conducting business in China such as China Mobile, China Unicom, China Telecom, Bank of China, Ping An Insurance, TCL, TNT Express, Watsons, Hutchison. All of our business units remain strong, and we continue to focus on penetrating the CRM and VAS/IVR

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markets through organic growth and by acquisition. With the launch of the 'iPACT' IVR-Alliance program, we hope to sign up new local IVR service providers to join our unified brand and strong IVR content and service offerings, under a chain of unified service standard under the iPACT brand. We look forward to revenue growth, market share improvement, and stronger partnerships with all the major telecom operators and local IVR service providers in China. With business activity increasing across all of our units, we are excited about the prospects for the Company in the coming quarters. We believe that our fundamentals are stronger than ever and that market opportunities for sustainable growth and profitability in China's CRM and VAS sector are vast. The following are some of the highlights of 2005:

- o In January, Watsons Water selected PacificNet Epro's WISE-xb Multimedia Contact Center System as its customer services initiative for its customer services center.

- o In January, PacificNet Linkhead, a leading provider of interactive voice response (IVR), voice chatline, mobile QQ, and other voice based value-added services in China, launched the Color Ring-back Tone (CRBT) services for China Unicom (NYSE:CHU) in Shandong and Henan. We partnered with North Tech, a leading system integrator and channel partner, in deploying the customized Color Ring-back Tone (CRBT) service for China Unicom Henan Province, with over 200,000 users based on both CDMA and GSM networks. With the CRBT service ("Cai-Ling"), subscribers can customize the ring tone from a wide selection of commercial music, personalized messages, celebrity greetings, or voice advertisements to replace the monotonous ring connecting tone that the caller would hear.

- o In February, we successfully deployed WISE-xb Interactive Voice Response System (IVRS) Contact Center Solution for TNT Hong Kong, a division of TPG NV and the world's leading business to business express delivery company, as TNT's key customer relationship management (CRM) initiative to enhance its customer services.

10

- o In March, we expanded our operations by acquiring entities that operate as service providers in the VAS & IVR industries, which have grown rapidly in China in recent years and to further develop products and services organically. On the acquisition front, the purchase of Guangzhou 3G Information Technology Co. Ltd. in April was a significant event. We purchased a 51% controlling interest, which is expected to help expand PacificNet's value-added service coverage to all of China through Guangzhou 3G's experienced operation team of 280 staff and sales offices in 26 provinces in China. Guangzhou 3G is one of the largest value-added telecom and information services providers in China with both voice and data connections to the four major telecom operators (China Mobile, China Unicom, China Telecom, and ChinaNetcom), covering both mobile and fixed-line networks.

- o In April, we were selected by Ping An Insurance ("Ping An"), the second largest life insurance company in China, to provide CRM consulting and call center training services to Ping An's main customer service center located in Suzhou with 300 seats and 500 customer service representatives.

- o In April, we have formed an alliance with the largest Call Center in Japan, under which we became designated agent for Bellsystem24, Inc. in China and Hong Kong. Bellsystem24 is Japan's largest telemarketing, call center and

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CRM services company with over 4,300 clients, 22,135 communication service representatives, 9,500 workstations, 160 system engineers, and 31 offices in Japan.

o In June, we formed a partnership with Epicor Software Corporation (NASDAQ:EPIC), a recognized global leader of software solutions for middle-market companies, to provide Customer Relationship Management (CRM) for Chinese companies.

o In July, we announced the launch of a new IVR-Alliance program called "iPACT" at the 2005 Voice Value-Added Service (VAS) Conference. Under this iPACT program, PacificNet plans to sign up qualified Voice-VAS and IVR service providers as profit sharing members in China under a unified brand "iPACT". PacificNet will provide to qualified VAS-Alliance partners, on a profit sharing basis, all of the hardware, software, application, and content for VAS, including a variety of IVR and other wireless and fixed-line VAS content. Mobile and fixed-line phone users can access PacificNet's VAS-Alliance services through Guangzhou 3G presence in 26 provinces in China.

o In August, PacificNet Clickcom, reached an agreement with China Unicom's Guangdong Branch to launch a new Mobile Mailbox Service called "UMAIL" for Unicom's CDMA users on its WAP Portal website. Guangdong is one of the largest and most affluent provinces in China and represents a significant opportunity for PacificNet to offer value-added telecom services. As of June 2005, China Unicom has 30.47 million CDMA users and 8.5 million WAP users nationwide. China Unicom's CDMA users in Guangdong may go to its WAP Portal, enter UMAIL service, and be able to send and receive e-mail by mobile phone.

o In October, PacificNet Epro acquired a 70% ownership interest in Guangzhou JunFeng Network Technology Co. Ltd. (JunFeng). The acquisition is expected to be additive to Epro's 2006 earnings.

o In November, PacificNet Linkhead was awarded an open project tender by Industrial and Commercial Bank of China ("ICBC"), the largest commercial bank in China with over 21,000 domestic branches, to develop its integrated IVR telephone banking system.

o In December, we continued to win high-profile government and private sector projects. We won a project tender by the City of Guangzhou, one of the largest and most affluent cities in China, to develop an Internet and intranet based e-business platform for Guangzhou Metro.

RECENT DEVELOPMENTS

Recently, we expanded our operations by acquiring entities that operate as Internet e-commerce providers and service providers in the wireless VAS & IVR industries, which have grown rapidly in China in recent years.

ACQUISITION OF GUANGZHOU WANRONG

In January 2006, we completed the acquisition of a 51% interest in Guangzhou Wanrong Information Technology Co., Ltd. ("Guangzhou Wanrong", <http://www.my2388.com>), one of the leading value-added telecom service providers in China. The acquisition is expected to be accretive to the Company's earnings in 2006. Since its inception in 2003, Guangzhou Wanrong has achieved strong

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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. Guangzhou Wanrong was granted nationwide SMS service numbers "2388" for China Mobile and "9928" for China Unicom. Wanrong's integrated value-added mobile services system is valuable for the implementation of PacificNet's "iPACT program", a standard service-mark for PacificNet's VAS profit-sharing alliance partnership program. See "Product and Service Offerings: Value-Added Telecom Services" above for a detailed description of the iPACT program.

We paid approximately US\$1.75million for the equity interest in Guangzhou Wanrong, which payable 21% in cash and 79% in restricted shares of PacificNet common stock payable in restricted shares of PacificNet valued at \$8 per share, or about 173,000 restricted shares. The purchase price is payable upon achievement of certain quarterly earn-out targets based on net income Under the purchase agreement, Guangzhou Wanrong is obligated to generate \$500,000 in annual net income. In the event of a shortfall, the purchase price will be adjusted accordingly. PacificNet will also invest approximately \$370,000 (or about RMB 3 million) in Guangzhou Wanrong for general corporate purposes.

ACQUISITION OF IMOBILE IN Q1 2006

iMobile operates its e-commerce business via two Internet portals ("<http://www.iMobile.com.cn>" and <http://www.18900.com>) and one WAP portal ("17wap.com") for mobile phone browsing. In addition, iMobile's 18900.com operation is the designated Internet distributor for Motorola, Nokia, and NEC's mobile products in China. 18900.com is the leading Internet e-commerce distributor of mobile products in China, and provides Internet, email, customer service centers, pre-sale and post-sale services, logistics and cash-on-delivery (COD) services to mobile related products in China. iMobile's 18900.com e-commerce operations combines both online Internet services with its offline customer services network composed of a nationwide chain of logistic and customer centers covering 21 provinces and 40 major cities in China, including Beijing, Shanghai, Chongqing, Tianjin, Chengdu, Dalian, Qingdao, Guangzhou, Shenzhen, Zhuhai, Dongguang, Hanzhou, Suzhou, Ningbo, Wenzhou, Nanjing, Wuhan, Xian, Harbin, Qiqihaer, Hunan and Changsha.

iMobile's Internet portal has been one of the top ranked traffic sites and has achieved about 2.3 million registered online users and over 400,000 active users, with 5 million daily page views and 20,000 blog postings per day, which makes iMobile the top ranked site in its category in China. The purchase consideration for 51% of the equity interest of iMobile is approximately US\$1.8 million, which represents approximately seven times the anticipated future annual net income of iMobile. The purchase consideration is payable 14% in cash and 86% in restricted shares of PacificNet valued at \$8 per share, or about 191,875 restricted shares. The purchase price is payable upon achievement of certain quarterly earn-out targets based on net income. Under the purchase agreement, iMobile has committed to generate \$500,000 in annual net income. In the event of a shortfall, the purchase price will be adjusted accordingly. PacificNet will also invest approximately \$250,000 (about RMB 2 million) in iMobile for general corporate and working capital purposes to support growth.

PRODUCTS AND SERVICES OFFERED

Our goal is to take a leading role in providing information technology services and network communications, which are rapidly expanding business sectors in Asia. The services offered by each of our subsidiaries can be classified within one of the following three business groups:

1. OUTSOURCING SERVICES

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BUSINESS PROCESS OUTSOURCING (BPO)

PACIFICNET EPRO HOLDINGS Limited ("Epro") operates our call center offering 24 hour staff-answering and automatic-answering service hotlines in our service areas, handling customer inquiries regarding services, billing, and technical support, as well as customer complaints. We offer services targeted at high-value and corporate customers. We provide them with dedicated account executives, on-site visits, and systems for collecting comments and handling complaints.

12

Epro is a leading provider of outsourced call-center services with over 15 years of field experience in greater China. Epro's business consists of the following three major categories:

(1) OUTSOURCED CALL CENTER SERVICES Epro's ISO 9001 certified outsourcing contact center hosts over 1,000 workstations and 1,200 agents, processing over 100,000 calls daily and provides multi-lingual inbound and outbound CRM services. The call center is the largest outsourced call center in Hong Kong. Epro permits its clients to recruit and hire their own personnel to work in its call center, for which Epro provides managerial services, call center seats, and equipment. Our inbound call center services include sales inquiry hotline, telephone orders, technical helpdesk, and customer service. Certain of our clients also engage us to provide telemarketing and telesales for their products and for promotions, to conduct market surveys, and to provide administrative functions, such as appointment setting.

(2) TRAINING AND CONSULTING SERVICES The Epro Call Center Training Institute (ECCTI) is a leading provider of Contact Center Management Consulting and Training services, which helps clients to maximize the return on investment of their CRM operations. Through ECCTI, we provide on-site training and consulting services, and we offer courses and seminars for call center managers and professionals, sales representatives, customer service representatives and telemarketing service representatives and in-house trainers.

(3) CALL CENTER MANAGEMENT SOFTWARE PRODUCTS AND SOLUTIONS WISE-xb Call Center agent performance management and reporting software is Epro's proprietary call center management software. Wise-xb has been installed in over 60 customer sites in the PRC. Epro's products also include Automatic Call Distribution (ACD) System, Unified Messaging System (UMS), SMS, and VAS.

INFORMATION TECHNOLOGY OUTSOURCING (ITO)

PACIFIC SMARTIME SOLUTIONS LIMITED ("Smartime") - Through Pacific Solutions Technology (Shenzhen) Company Limited, its operating subsidiary in Shenzhen, China, Smartime provides outsourced consulting services and programming services, including software development, R&D, and project management to leading telecom, banking and financial services companies including Huawei, IBM, Bank of East Asia and others.

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PACIFICNET SOLUTIONS LIMITED ("PacSo") - PacSo specializes in systems integration, software application, and e-business solutions services in Hong Kong and Greater China. The scope of PacSo's products and services includes smart card solutions, web based front-end applications and web based connections to backend enterprise planning systems.

2. VALUE-ADDED TELECOM SERVICES (VAS)

CHINAGOHI - Through our subsidiary, ChinaGoHi, we provide China with telemarketing services, financial advisory services, and infomercial marketing services, including Direct Response Television (DRTV) infomercials through satellite, cable tv broadcasting, and web portals. We also offer subscription-based value-added services including Internet email, short message services (SMS), mobile WAP services, and interactive voice response (IVR) services via fixed-line and mobile phones.

LINKHEAD - Linkhead is a value-added reseller and provider of VAS, such as IVR system development and integration, SMS, and voice-portal services. Linkhead is also a channel partner, or a master reseller, of NMS Communications system hardware, a leading provider of communications technologies. Linkhead also acts as a mobile phone systems integrator for service providers in China, providing the hardware, know-how, and software for mobile phone VAS, such as mobile chat, mobile karaoke, and color ring back tone. The service providers ultimately provide the Linkhead systems to telecom operators, such as China Unicom and China Netcom.

CLICKCOM-WOFE - Through Clickcom-WOFE and its affiliated company Dianxun-DE we can offer, directly to China's telecom operators, a wide variety of wireless Internet services for mobile phones, such as SMS, Wireless Application Protocol (WAP), which allows users to access information instantly via handheld wireless devices, and Java mobile applications. The acquisition of Clickcom-WOFE was our first step in entering the VAS service provider market where we anticipate designing our own mobile phone VAS for distribution directly to telecom operators.

13

GUANGZHOU3G-WOFE - Guangzhou3G-WOFE is one of the largest value-added telecom and information services providers in China with both voice (IVR and call center) and data (SMS, MMS, WAP, JAVA, GPRS) connections to the four major telecom operators: China Mobile, China Unicom, China Telecom, and China Netcom, covering both mobile and fixed-line networks. Guangzhou 3G also offers a wide variety of IVR and other wireless and fixed-line, value-added telecom services including color ring back tone (CRBT) services, background music (BGM) services, VICQ mobile instant messaging services, sports and soccer news, weather forecasts, stock prices, jokes, short stories, dramas, songs and mobile karaoke, mobile TV, games, entertainment, as well as community-oriented services, such as chatline and dating services. Mobile and fixed-line phone users can access Guangzhou 3G IVR services through one of the four major telecom operators' networks.

IPACT INTERNATIONAL INVESTMENT LIMITED - IPACT plans to sign up qualified Voice-VAS and IVR service providers as profit sharing members in China under a unified brand "iPACT." We will provide to qualified VAS-Alliance partners, on a profit sharing basis, all of the hardware, software, application, and content for VAS, including a variety of IVR and other wireless and fixed-line VAS

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content, including color ring back tone (CRBT) services, background music (BGM) services, VICQ mobile instant messaging services, sports news, weather forecasts, stock market, humor, songs and mobile karaoke, mobile TV, games, entertainment, as well as community-oriented services, such as chatline and dating services. Mobile and fixed-line phone users can access PacificNet's VAS-Alliance services through Guangzhou 3G presence in 26 provinces in China.

PACIFICNET AD. LIMITED - PacificNet Ad. Limited was newly formed in December 2005 in Hong Kong and provides advertising and media services.

3. COMMUNICATION PRODUCTS DISTRIBUTION

YUESHEN - Yueshen distributes telecom services for mobile phones, such as calling cards, mobile SIM cards, prepaid stored-value cards, wireless broadband and Internet services for mobile phones. We sell calling cards wholesale to distributors who in turn sell to retail shops, such as newsstands. We have entered the retail calling card market and have established nine retail stores in the Guangzhou Metro. Yueshen is the designated distributor of China Netcom's XiaoLingTone/PHS mobile phone products, prepaid calling cards, wireless broadband and Internet services.

IMOBILE - iMobile's Internet portal has been one of the top ranked traffic sites and has achieved about 2.3 million registered online users and over 400,000 active users, with 5 million daily page views and 20,000 blog postings per day, which makes iMobile the top ranked site in its category in China.

PACIFICNET COMMUNICATIONS LIMITED - PacificNet communication (referred to herein as "PacCom"), was incorporated in Hong Kong, and is a wholly owned subsidiary of PacificNet that specializes in telecom related services in Hong Kong and Greater China.

PRINCIPAL CUSTOMERS

Our principal customers in each of our business groups are located in Hong Kong, mainland China and other regions of Asia. Our key clients consist of leading telecom operators, banks, insurance, travel, marketing, government, services companies and telecom consumers.

1. OUTSOURCING SERVICES (INCLUDING BPO, ITO, CALL CENTER SERVICES) CUSTOMERS

The following is a brief description of some of the Company's customers in the outsourcing services group:

HUTCHISON TELECOM - A subsidiary of Hutchison Whampoa Ltd, is one of the world's leading owners and operators of telecommunications, offering a wide range of communication services in Hong Kong and around the globe including mobile telephony (voice and multimedia), paging, trunked radio, fixed-line services, Internet services, fiber optic broadband networks and radio broadcasting.

PCCW LIMITED - A leading telecommunications carrier and service provider in Hong Kong.

SUNDAY COMMUNICATIONS LIMITED - One of the six mobile operators in Hong Kong, SUNDAY was granted a mobile carrier license in Hong Kong to construct and operate a 3G network. SUNDAY offers its mobile subscribers basic airtime

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services, value-added services, enhanced services, short messaging services, wireless data services, roaming services and international long distance calling services, and sells accessories.

BANK OF CHINA GROUP INSURANCE COMPANY (BOCGI) - BOCGI owns 6 branches and one wholly owned subsidiary life insurance company (Bank of China Group Life Assurance Company Ltd.) in Hong Kong and Mainland China.

AMERICAN EXPRESS BANK (HONG KONG) - A diversified worldwide travel, financial and network services company founded in 1850. It is a world leader in charge and credit cards, Travelers Cheques, financial planning, business services, insurance and international banking.

ACNIELSEN (CHINA) LTD. - The world's leading provider of market research, information and analysis to the consumer products and services industries, primarily in retail measurement, consumer panel research, customized research and media measurement, as well as to government and social services.

HSBC - One of the largest banking and financial services organizations in the world. HSBC's international network comprises over 9,500 offices in 76 countries and territories in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa.

SO-NET, HONG KONG - A wholly owned subsidiary of Sony Corporation of Hong Kong Limited. So-net was granted a sub-license from Sony Communication Network Corporation (SCN) to create a broadband service under the So-net brand. So-net has become the third largest Internet Service Provider in Japan with a subscriber base of 1.7 million. Sony is a leading manufacturer of audio, video, game, communications and information technology products for the consumer and professional markets

TCL CORPORATION - A leading consumer electronics brand in China that runs its business from multimedia to mobile phones, from personal computers to home appliances, from electric lighting to digital products.

HONG KONG GOVERNMENT - Hong Kong Housing Authority - The Hong Kong Housing Authority (HA) was established as a statutory body in April 1973 under Hong Kong's Housing Ordinance. Within the Government's overall housing policy framework, the HA determines and implements public housing programs.

2. VALUE-ADDED TELECOM SERVICES (VAS) CUSTOMERS

CHINA TELECOM - The largest fixed service telecommunications provider in China, which includes data, Internet, and the XiaoLingTong PAS wireless system.

CHINA NETCOM - One of the four major telecom carriers in China, which includes fixed line, data, Internet, and the XiaoLingTong wireless system.

CHINA MOBILE - The largest mobile operator in China.

CHINA UNICOM - One of the major mobile operators in China operating both GSM and CDMA mobile networks, long-distance call, local call, data communication including Internet service and IP phone, value-added telecom service, wireless paging and a variety of relevant services.

3. COMMUNICATION PRODUCTS DISTRIBUTION CUSTOMERS

China Telecom, China Netcom, China Mobile and China Unicom are our primary customers.

MOTOROLA - A world leader in wireless and broadband communications.

NOKIA - Nokia is a world leader in mobile communications, with products like mobile phones, devices and solutions for imaging, games, media and businesses. Nokia provides equipment, solutions and services for network operators and corporations.

SALES AND MARKETING

We do not engage in any significant marketing activities. We advertise our services by attending various CRM and VAS trade shows and conferences in China. There are a limited number of competitors in our industry; accordingly, new business opportunities are generated mainly through business contacts and by word of mouth. We rely on our reputation for quality and efficiency among our customers and leveraging our strategic investors to obtain new business.

GOVERNMENT REGULATION

We operate our business in China under a legal regime that consists of the State Council, which is the highest authority of the executive branch of the PRC central government, and several ministries and agencies under its leadership, including:

- o the Ministry of Information Industry (MII);
- o the China Securities Regulatory Commission (CSRC);
- o the Ministry of Culture;
- o the General Administration of Press and Publication of the P.R. China;
- o the State Copyright Bureau;
- o the State Administration of Industry and Commerce (SAIC);
- o the Ministry of Public Security; and
- o the Ministry of Commerce.

The State Council and these ministries and agencies have issued a series of rules that regulate a number of different substantive areas of our business, which are discussed below.

FOREIGN OWNERSHIP RESTRICTION ON BUSINESSES ENGAGED IN PROVIDING INTERNET CONTENT

PRC regulations currently limit foreign ownership of companies that provide Internet content services to 50%. This limitation extends to our IVR, call center and telecom VAS and to our business of providing financial information and data to Internet users. To comply with this foreign ownership restriction, with respect to our Internet content services, we operate our website in China through Shenzhen DongFang Digital Port Technology Development Company Limited ("DongFang Digital"), which is 59% owned by Mr. Wang Wen Ming, the Chairman and CEO of ChinaGoHi, who is a PRC citizen. Under PRC law, we cannot hold the licenses and obtain the approvals necessary to operate the website because those licenses and approvals can not be held by foreign entities or majority foreign-owned entities. Furthermore, because Lion Zone and ChinaGoHi are wholly owned foreign enterprises, they cannot hold such licenses or obtain the approvals.

There are substantial uncertainties regarding the interpretation and application of current or future PRC laws and regulations with respect to our acquisition model. In the opinion of our in-house PRC legal counsel, our current ownership

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structure, the contractual arrangements among our wholly owned subsidiaries and the operating company and their shareholders comply with all existing applicable PRC laws, rules and regulations. We cannot assure that the PRC regulatory authorities will not ultimately take a view that is contrary to the opinion of our PRC legal counsel. If the PRC government finds that the agreements that establish the structure of our operations in China do not comply with PRC government restrictions on foreign investment in our industry, we could be subject to severe penalties.

LICENSES AND PERMITS

There are a number of aspects of our business which require us to obtain licenses from a variety of PRC regulatory authorities. For example, in order to host our website, DongFang Digital is required to hold an Internet content provider, or ICP, license issued by the Ministry of Information Industry or its local offices. DongFang Digital currently holds an ICP license issued by Ministry of Information Industry Guangdong department. Each ICP license holder that provides analysis and research information relating to stocks and other

16

securities must obtain a securities advisory permit from China Securities Regulatory Commission, or the CSRC. Our subsidiary ChinaGoHi currently holds a securities advisory permit, which allows it to operate in securities investment consultancy service. We also receive securities analysis and research information from other licensed securities advisors that hold securities advisory permits, and we have disclosed on our websites, reports, and in our software the sources of such information as required by the CSRC.

A recent regulation issued by the Ministry of Information Industry requires short message, or SMS, content providers to obtain an SMS license from the Ministry of Information Industry or its local offices. DongFang Digital has obtained the required SMS license for the delivery of our financial short message content. Furthermore, the Ministry of Information Industry has promulgated rules requiring ICP license holders that provide online bulletin board services to register with, or obtain an approval from, the relevant telecommunications authorities. DongFang Digital has obtained such approval from Guangdong Communications Administration, the government agency in charge of this matter in Guangdong and Shenzhen.

REGULATION OF INTERNET CONTENT

The PRC government has promulgated measures relating to Internet content through a number of ministries and agencies, including the Ministry of Information Industry, the Ministry of Culture and the State Press and Publications Administration. These measures specifically prohibit Internet activities that result in the publication of any content which is found to, among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of the PRC, or compromise State security or secrets. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites. DongFang Digital's ICP license expressly states that it is not allowed to publish news, among other things, in relation to its Internet content provision. Specifically, Shenzhen, Beijing and Guangzhou branches of the General Administration of Press and Publication of the PRC, the government authority regulating news publication, confirmed with us that so long as we do not provide general news on politics, society or culture, or establish a "news column," or provide such information

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under express heading of "news," we are not required to obtain a license to publish financial or economic related news content.

REGULATION OF INFORMATION SECURITY

Internet content in China is also regulated and restricted by the PRC government to protect State security. The National People's Congress, China's national legislative body, has enacted a law that may subject to criminal punishment in China any effort to: (1) gain improper entry into a computer or system of strategic importance; (2) disseminate politically disruptive information; (3) leak State secrets; (4) spread false commercial information; or (5) infringe intellectual property rights.

The Ministry of Public Security has promulgated measures that prohibit use of the Internet in ways which, among other things, result in a leakage of State secrets or a spread of socially destabilizing content. The Ministry of Public Security has supervision and inspection rights in this regard and we may be subject to the jurisdiction of the local security bureaus. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its websites.

INTELLECTUAL PROPERTY RIGHTS

The State Council and the State Copyright Bureau have promulgated various regulations and rules relating to protection of software in China. Under these regulations and rules, software owners, licensees and transferees should register their rights in software with the State Copyright Bureau or its local offices and obtain software copyright registration certificates. Although such registration is not mandatory under PRC law, software owners, licensees and transferees are encouraged to go through the registration process. Therefore persons with registered software rights may receive better protection. We have registered all of our self-developed software with the State Copyright Bureau.

PRC law requires owners of Internet domain names to register their domain names with qualified domain name registration agencies approved by the Ministry of Information Industry and obtain a registration certificate from such registration agencies. A registered domain name owner has an exclusive use right over its domain name. Unregistered domain names may not receive proper legal protections and may be misappropriated by unauthorized third parties. Our primary domain names, www.ChinaGoHi.cn and www.GHGC.cn are registered with CNNIC, a domain name registration agency approved by the Ministry of Information Industry. In addition, we have registered another domain name, www.FMM88.com, with the Internet Corporation for Assigned Names and Numbers, or ICANN, an internationally organized, non-profit corporation that has responsibility for Internet Protocol (IP) address space allocation.

PRIVACY PROTECTION

PRC law does not prohibit Internet content providers from collecting and analyzing personal information from their users. On our website, our users are required to accept a user agreement whereby they agree to provide certain personal information to us. PRC law prohibits Internet content providers from disclosing to any third parties any information transmitted by users through their networks unless otherwise permitted by law. If an Internet content provider violates these regulations, the Ministry of Information Industry or its

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local offices may impose penalties and the Internet content provider may be liable for damages caused to its users.

ADVERTISING REGULATION

PRC law requires entities conducting advertising activities to obtain an advertising permit from the SAIC's local offices. Entities conducting advertising activities without such permit may be charged a fine or imposed other penalties by the SAIC's local offices. Currently, foreign investors cannot own more than 70% equity interest in an advertising agency in China. DongFang Digital holds an advertising permit.

COMPETITION

We expect competition to persist and intensify in the future. Our competitors include small firms offering specific applications, divisions of large entities and large independent firms. A number of competitors have or may develop greater capabilities and resources than ours. We face the risk that new competitors with greater resources than ours will enter our market. Our competitors are mainly leaders in the CRM and VAS markets. Competitive pressures from current or future competitors could cause our services to lose market acceptance or require a significant reduction in the price of our services.

1. OUTSOURCING SERVICES (INCLUDING BPO, ITO, CALL CENTER SERVICES) COMPETITORS:

PCCW is one of Asia's leading integrated communications services companies, providing local telephony and broadband services to businesses.

Chinasoft International Limited, or ICSS, is a leading e-government solution provider and software developer in the PRC, and has entered the software outsourcing, interrelated systems integration, consultancy and training services industry.

2. VALUE-ADDED TELECOM SERVICES (VAS) COMPETITORS:

China Finance Online Co. Ltd., (NASDAQ:JRJC), is one of the leading companies that specialize in providing online financial and listed company data and information in China. They offer subscription-based services based on a single information platform that integrates data and information from multiple sources with features and functions such as data and information search, retrieval, delivery, storage and analysis.

TOM Online Inc. (NASDAQ:TOMO), is a leading wireless Internet company in China providing value-added multimedia products and services, targeting the young and trendy demographics. The company's primary business activities include wireless value-added services and online advertising. The company offers an array of services such as SMS, MMS, WAP, wireless IVR (interactive voice response) services, content channels, search and classified information, and free and fee-based advanced email.

SINA Corporation (NASDAQ:SINA) is a leading online media company and value-added information service (VAS) provider for China and for Chinese communities worldwide offering Internet users and government and business clients an array of services.

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3. COMMUNICATION PRODUCTS DISTRIBUTION COMPETITORS

There are various smaller regional players in the communications distribution industry.

EMPLOYEES

As of December 31, 2005, together with our subsidiaries, we had approximately 2,300 employees and contractors. We have not experienced any labor stoppages. None of our employees are covered by collective bargaining agreements. The breakdown of number of employees for each of the business units of the Company is as follows:

COMPANY AND SUBSIDIARIES	NUMBER OF EMPLOYEES
PacificNet Inc.	5
PacificNet Limited (Hong Kong)	12
PacificNet Beijing	16
PacificNet Shenzhen	13
PacificNet Guangzhou	1
PacificNet Solutions Ltd.	1
PacificNet Power Ltd.	4
Epro Telecom Holdings Limited	750
Beijing Linkhead Technologies Company Limited	60
Guangzhou Yueshen TaiYang Technology Limited	32
Smartime / Soluteck Technology (Shenzhen) Company Limited	170
Guangzhou 3G	280
Clickcom	10
ChinaGoHi	860
Wanrong	42
iMobile	58
	2314
	2314
RESEARCH AND DEVELOPMENT	

We place great emphasis on the continued enhancement of our existing products and solutions, including designing, developing and supporting a portfolio of converged voice and data enhanced services, products and solutions to help wireless, fixed-line and Internet service providers offer unprecedented access to communications, information and commerce. We have ongoing research and development activities with respect to the following products and solutions:

- o multi-media information on demand systems, which integrates the dynamics of the Internet with voice-based communication applications, including text-to-speech and voice recognition capabilities;
- o web-based multimedia call center/customer relationship management for service providers and corporations;
- o WISE-xb, which is a call center agent performance management and reporting software. It provides intelligent routing, comprehensive ACD/PBX capabilities, Email, IVR, Voice Mail, Messaging, Conference, Recording, Coaching/Supervising, Reporting and Interface.;
- o voice mail systems;
- o color ringback tone systems; and
- o value-added services for mobile users.

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EXECUTIVE OFFICES

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

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

PacificNet Shenzhen Office: Room 901, Tower A, Tian An High-Tech Plaza, Tian An Cyber Park, Fu Tian District, Shenzhen, China Postal Code: 518040

PacificNet Guangzhou Office: 15/F, Building A, Huajian Plaza, No. 233 Tianfu Road, Tianhe District, Guangzhou, China Postal Code: 510630

PacificNet Beijing Office: 23/F, Building A, TimeCourt, No.6 Shuguang Xili, Chaoyang District, Beijing, China Postal Code: 100028 Tel:86-010-59225000

PacificNet Inc., 860 Blue Gentian Road, Suite 360, Eagan, MN 55121-1575, USA. Tel: +1-651-209-3100, Fax: +1-651-209-3103, Email: IR@PacificNet.com

We maintain a website at www.PacificNet.com.

20

RISK FACTORS

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

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

RISKS RELATED TO OUR BUSINESS

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

Our business operations commenced in 1994, and subsequently the business was incorporated as a Delaware corporate entity in 1999. Our operating history may be insufficient to evaluate our business and future prospects. Although our revenue have grown rapidly in the past two years, primarily as a result of our

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increased acquisition activity, we cannot assure investors that we will maintain our profitability or that we will not incur net losses in the future. We expect that our operating expenses will increase as we expand. Any significant failure to realize anticipated revenue growth could result in significant operating losses. We will continue to encounter risks and difficulties in implementing our business model, including our potential failure to:

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

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

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

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

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

Our acquisitions could result in the use of substantial amounts of cash, potentially dilutive issuances of equity securities, significant amortization expenses related to goodwill and other intangible assets and exposure to undisclosed or potential liabilities of acquired companies. During the fiscal year ended December 31, 2005, we acquired a controlling interest in Guangzhou 3G Information Technology Co. Ltd. ("Guangzhou3G-WOFE") Click-WOFE and Shenzhen GuHaiGuanChao Investment Consultant Company Limited ("ChinaGoHi"), a wholly owned foreign enterprise (WOFE) registered in China. We expect that acquisitions

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will strengthen our position as a provider of outsourced call center, VAS and communication products in Asia. Although our agreements provide that the consideration is payable upon the acquired company attaining certain income milestones annually, there is no guarantee that these milestones will be reached. If they are not reached as anticipated, the time, cost and capital to acquire the company may outweigh the anticipated benefits from consolidation of their income. PacificNet recorded approximately \$8.88 million of goodwill as a result of several acquisitions that is not subject to amortization in the ordinary course of business. To the extent that the businesses acquired in these transactions do not remain competitive, some or all of the goodwill related to that acquisition could be charged against future earnings.

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

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

Currently, China Mobile and China Unicom are the only mobile telecommunications operators in China that have platforms for wireless value-added services. Our agreements with them are generally for a period of less than one year and generally do not have automatic renewal provisions. If neither of them is willing to continue to cooperate with us, we will not be able to conduct our existing wireless value-added services business.

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

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

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

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

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

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

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

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

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

OUR COMMUNICATION PRODUCTS ARE PROVIDED CASH-ON-DELIVERY, WHICH LEAVES US VULNERABLE TO THEFT AND EMPLOYEE EMBEZZLEMENT. The purchase of calling cards, SIM cards and other mobile phone products are made with cash. Although there is a low risk that clients will not pay for these services when delivered, our retail stores maintain large sums of money which might make them robbery targets. We also face the risk that employees who collect the cash and others who may be aware that cash is available at these sites might embezzle the money. Theft or embezzlement could have a material adverse effect on the revenue generated and the financial condition of our business operations.

WE INTEND TO OPERATE EACH OF OUR ACQUIRED BUSINESSES ON A STANDALONE BASIS. We do not intend to integrate the information or communications systems,

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

BECAUSE WE DO NOT HAVE EMPLOYMENT AGREEMENTS WITH MANAGEMENT OF THE ACQUIRED COMPANIES, OUR BUSINESS OPERATIONS MIGHT BE INTERRUPTED IF THEY WERE TO RESIGN AND SEEK EMPLOYMENT WITH COMPETITORS. As part of our acquisition strategy, we do not use our own employees or members of our management team to operate the acquired companies. Key management at these companies has been in place for

23

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

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

THE MARKET IN WHICH WE COMPETE IS HIGHLY COMPETITIVE AND FRAGMENTED AND WE MAY NOT BE ABLE TO MAINTAIN MARKET SHARE. We expect competition to persist and intensify in the future. Our competitors are mainly leaders in the CRM services market, such as PCCW Teleservices (Hong Kong) Limited, China Motion Telecom International Limited, and Teletech (Hong Kong) Limited. Our competitors also include small firms offering specific applications, divisions of large entities and other large independent firms. We face the risk that new competitors with greater resources than ours will enter our market. Furthermore, increasing competition among telecom companies in greater China has led to a reduction in telecommunication services fees that can be charged by such companies. If a reduction in telecommunication services fees negatively impacts revenue generated by our clients, they may require us to reduce the price of our services, or seek competitors of ours that charge less. If we must significantly reduce the price of our services, the decrease in revenue could adversely affect our profitability.

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

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

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

OUR OPERATIONS COULD BE CURTAILED IF WE ARE UNABLE TO OBTAIN REQUIRED ADDITIONAL FINANCING. Since inception our investments and operations primarily have been financed through sales of our common stock. During the fiscal year ended December 31, 2005, we completed two private placements of our common stock in which we received approximately \$9,300,000 of gross proceeds. In the future we may need to raise additional funds through public or private financing, which may include the sale of equity securities, including securities convertible into our common stock. The issuance of these equity securities could result in dilution to our stockholders. If we are unable to raise capital when needed, our business growth strategy may slow, which could severely limit our ability to increase revenue.

EFFORTS TO COMPLY WITH RECENTLY ENACTED CHANGES IN SECURITIES LAWS AND REGULATIONS WILL INCREASE OUR COSTS AND REQUIRE ADDITIONAL MANAGEMENT RESOURCES AND WE STILL MAY FAIL TO COMPLY. As directed by Section 404 of the Sarbanes-Oxley Act of 2002, the SEC adopted rules requiring public companies to include a report of management on the company's internal controls over financial reporting in their annual reports on Form 10-K. In addition, the independent public accounting firm auditing the company's financial statements must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. This requirement will first apply to our annual report on Form 10-K for our fiscal year ending December 31, 2007. If we are unable to conclude that we have effective internal controls over financial reporting or, if our independent auditors are unable to provide us with an unqualified report as to the effectiveness of our internal controls over financial reporting beginning with the fiscal year ended December 31, 2007 as required by Section 404 of the Sarbanes-Oxley Act of 2002, investors could lose confidence in the reliability of our financial statements, which could result in

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a decrease in the value of our securities.

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

WE HAVE NEVER PAID CASH DIVIDENDS AND ARE NOT LIKELY TO DO SO IN THE FORESEEABLE FUTURE. We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for use in the operation and expansion of our business. We do not expect to pay any cash dividends in the foreseeable future but will review this policy as circumstances dictate.

RISKS ASSOCIATED WITH DOING BUSINESS IN GREATER CHINA

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

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

Changes in laws and regulations, or their interpretation, or the imposition of confiscatory taxation, restrictions on currency conversion, imports and sources of supply, devaluations of currency or the nationalization or other expropriation of private enterprises could have a material adverse effect on our business, results of operations and financial condition. Under its current leadership, the Chinese government has been pursuing economic reform policies that encourage private economic activity and greater economic decentralization. There is no assurance, however, that the Chinese government will continue to pursue these policies, or that it will not significantly alter these policies from time to time without notice.

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

Our reporting currency is the U.S. dollar and our operations in China and Hong Kong use their respective local currencies as their functional currencies. The majority of our revenue derived and expenses incurred are in Chinese renminbi

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

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

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

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

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

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

The Chinese government has enacted some laws and regulations dealing with matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, their experience in implementing, interpreting and enforcing these laws and regulations is limited, and our ability to enforce commercial claims or to resolve commercial disputes is unpredictable. If our new business ventures are unsuccessful, or other adverse circumstances arise from these transactions, we face the risk that the parties to these ventures may seek ways to terminate the transactions, or, may hinder or prevent us from accessing important information regarding the financial and business operations of these acquired companies. The resolution of these matters may be subject to the exercise of considerable discretion by agencies of the

26

Chinese government, and forces unrelated to the legal merits of a particular matter or dispute may influence their determination. Any rights we may have to specific performance, or to seek an injunction under PRC law, in either of these cases, are severely limited, and without a means of recourse by virtue of the Chinese legal system, we may be unable to prevent these situations from occurring. The occurrence of any such events could have a material adverse effect on our business, financial condition and results of operations.

WE MUST COMPLY WITH THE FOREIGN CORRUPT PRACTICES ACT.

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

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

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

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

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

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

We depend on operating companies in which we have little or no equity ownership interest and must rely on contractual agreements to control and operate these businesses. Our contractual agreements with each of the operating companies may

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

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with our operating companies, which may in turn have a material adverse effect on our business operations.

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

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

RISKS RELATED TO OUR TECHNOLOGY AND EQUIPMENT

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

Our operations depend on our ability to protect our call centers, data centers, CRM information, customer database, data warehouse, computer and telecommunications equipment and software systems against damage from fire, power loss, telecommunications interruption or failure, hacker attacks, natural disaster, epidemic, terrorism, act of war and other similar events. In the event we experience a temporary or permanent interruption at one or more of our call centers, through casualty, operating malfunction or otherwise, our business could be materially adversely affected and we may be required to pay contractual damages to some clients or allow some clients to terminate or renegotiate their

28

contracts with us. While we maintain certain property and business interruption insurance, such insurance may not adequately compensate us for all losses that we may incur and may not be adequate to cover the costs of rebuilding these centers. If we are unable to restore our operations, our business activities would cease.

WE MUST RESPOND QUICKLY AND EFFECTIVELY TO NEW TECHNOLOGICAL DEVELOPMENTS.

Our VAS business is highly dependent on our computer and telecommunications equipment and software systems. Our failure to maintain the superiority of our technological capabilities or to respond effectively to technological changes could adversely affect our business, results of operations or financial

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condition. Our future success also depends on our ability to enhance existing software and systems and to respond to changing technological developments. If we are unable to successfully develop and bring to market new software and systems in a timely manner, our competitors technologies or services may render our products or services noncompetitive or obsolete.

RISKS RELATED TO OUR COMMON STOCK

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

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

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

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

In March 2006, we issued \$8 million in convertible debentures due March 2009. The debentures are convertible at any time into shares of our common stock at an initial fixed conversion price of \$10.00 per share, subject to adjustments for certain events. If any event of default occurs under the debentures or other related documents, the holders may elect to accelerate the payment of the outstanding principal amount of the debenture, plus accrued, but unpaid interest, liquidated damages or other amounts, which shall become immediately due and payable. Beginning January 1, 2007, we shall redeem up to \$320,000 every month, plus accrued, but unpaid interest, liquidated damages and penalties. We may choose to pay such redemption amount in cash, or, subject to meeting certain conditions, we may pay all or a part of the redemption amount in shares of

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common stock. We may not have enough cash on hand or have the ability to access cash to pay the redemption amount, or upon acceleration of the debenture in the case of an event of default, or at maturity. In addition, the redemption of the debentures with our shares or the conversion of the debentures into shares of common stock could result in dilution of our basic earnings per share.

29

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

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

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

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

As of December 31, 2005, we had 12,000,687 shares of common stock issued, which shares will be available to be sold in the public market in the near future, subject to, with respect to shares of common stock held by affiliates and shares issued between 12 and 24 months ago, the volume restrictions and/or manner of sale requirements of Rule 144 under the Securities Act. On February 4, 2005, a registration statement on Form SB-2 was declared effective with respect to 2,702,230 shares of our common stock. These shares are freely tradable without restriction or further registration, subject to the related prospectus delivery requirements. Sales by our current shareholders of a substantial number of shares could significantly reduce the market price of our common stock.

As of December 31, 2005, we had stock options outstanding to purchase an aggregate of 1,384,100 shares of common stock, of which 529,000 stock options were exercisable and warrants outstanding to purchase 591,138 shares of our common stock. To the extent that the options and warrants are exercised, they may be exercised at prices below the price of our shares of common stock on the public market, resulting in a significant number of shares entering the public market and the dilution of our common stock. Further, in March 2006, we completed a private placement of \$8,000,000 in convertible debentures. The debenture