PACIFICNET INC
Form 10QSB
May 16, 2005

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

FORM 10-QSB

/X/QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 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	91-2118007
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
601 New Bright Building, 11 Sheung Yuet Road, Kowloon Bay, Kowloon, Hong Kong	N/A
(Address of principal executive offices)	(Zip Code)

REGISTRANT'S TELEPHONE NUMBER: 011-852-2876-2900

UNIT 2710, HONG KONG PLAZA, 188 CONNAUGHT ROAD WEST, HONG KONG
(Former Name and Address)

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

There were 9,848,583 shares of the Company's common stock outstanding on March 31, 2005.

Transitional Small Business Disclosure Format (check one): YES / / NO / X /

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	MARCH 31, 2005 (UNAUDITED)	DECEMB (
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,323	$
Restricted cash - pledged bank deposit	3,501	
Accounts Receivables (net of allowance for doubtful accounts of $0)	5,842	
Inventories	1,727	
Other Current Assets	6,103	
TOTAL CURRENT ASSETS	19,496	
Property and Equipment, net	1,059	
Investments in affiliated companies and subsidiaries	1,260	
Marketable equity securities - available for sale	65	
Goodwill	9,132	

TOTAL ASSETS	$ 31,012	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Bank Line of Credit	$ 69	$
Bank Loans-current portion	1,035	
Capital Lease Obligations - current portion	113	
Accounts Payable	1,271	
Accrued Expenses and other payables	524	
Income tax payable	--	
Due to related party	467	
TOTAL CURRENT LIABILITIES	3,479	
Long-term liabilities:		
Bank Loans - non current portion	77	
Capital Lease Obligations - non current portion	126	
Total Long-Term Liabilities	203	
TOTAL LIABILITIES	3,682	
Minority Interests in Consolidated Subsidiaries	2,198	
Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock, par value $0.0001, Authorized - 5,000,000 shares		
Issued and outstanding - none	--	
Common Stock, par value $0.0001, Authorized - 125,000,000 shares		
Issued and outstanding:		
March 31, 2005 - 10,684,737 issues; 9,848,583 outstanding		
December 31, 2004 - 10,627,737 shares, 9,791,583 outstanding	1	
Treasury Stock, at cost (836,154 shares)	(104)	
Additional Paid-In Capital	53,919	
Cumulative Other Comprehensive Loss	(24)	
Accumulated Deficit	(28,660)	(
TOTAL STOCKHOLDERS' EQUITY	25,132	
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 31,012	$

See condensed notes to consolidated financial statements.

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

	THREE MONTHS ENDED MARCH 31, 2005	2004
Revenues	$ 9,133	$ 3,502

Cost of Revenues	(7,483)	(2,253)
Gross Profit	1,650	1,249
Selling, General and Administrative expenses	(810)	(777)
Depreciation and amortization	(43)	(67)
EARNINGS FROM OPERATIONS	797	405
Other income (expense), net	93	64
EARNINGS BEFORE INCOME TAXES AND MINORITY INTEREST	890	469
Provision for income taxes	(24)	--
Share of loss of associated companies	(8)	--
Minority Interests	(443)	(328)
NET EARNINGS AVAILABLE TO COMMON STOCKHOLDERS	$ 415	$ 141
BASIC EARNINGS PER COMMON SHARE:	$ 0.04	$ 0.02
DILUTED EARNINGS PER COMMON SHARE:	$ 0.04	$ 0.02

See condensed notes to consolidated financial statements.

PACIFICNET INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands of United States dollars, except loss per share and share amounts)

	THREE MONTHS ENDED MARCH	
	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net earnings	$ 415	$ 141
Adjustment to reconcile net earnings to net cash used in operating activities:		
Minority Interest	(198)	809
Depreciation and amortization	43	67
Accounts receivable and other current assets	(1,976)	(2,285
Inventories	(430)	(580
Income taxes	(10)	--
Accounts payable and accrued expenses	(1,482)	808

Net cash used in operating activities	(3,638)	(1,040
CASH FLOWS FROM INVESTMENT ACTIVITIES		
Increase in purchase of marketable securities	(36)	--
Acquisition of property and equipment	63	(128
Acquisition of subsidiaries	(233)	(232
Net cash used in investing activities	(206)	(360
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES:		
Dividend paid to minority interest shareholders	(339)	--
Loans from related parties	467	--
Repayment of amount borrowed	(836)	(2,812
Proceeds from sale of common stock	--	2,813
Proceeds from exercise of stock options	111	55
New bank loans	--	1,645
Net cash provided by (used in) financing activities	(597)	1,701
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(4,441)	301
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	6,764	3,823
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 2,323	$ 4,124
CASH PAID FOR:		
Interest	$ 45	59
Income taxes	$ 34	--
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Investment in subsidiaries acquired through issuance of common stock	--	$ 4,000
Common stock issued as a result of exercise of stock options	--	$ 5

See condensed notes to consolidated financial statements.

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

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for all periods presented have been made.

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include provisions for returns and impairment losses, accounting for income taxes, bad debts, and property, plant and equipment lives for depreciation purposes. Actual results may differ from these estimates. The results of operations for the three-month period ended March 31, 2005 are not necessarily indicative of the operating results that may be expected for the entire year ending December 31, 2005. These financial statements should be read in conjunction with the Management's Discussion and Analysis included in elsewhere in this report and the financial statements and notes thereto included in the Company's 2004 Annual Report on Form 10-KSB.

2. EARNINGS PER SHARE

Basic earnings per share are based on the weighted average number of shares of common stock outstanding. Diluted earnings per share is based on the weighted average number of shares of common stock outstanding and dilutive common stock equivalents. All earnings per share amounts in these financial statements are basic earnings per share as defined by SFAS No. 128, "Earnings Per Share." Diluted EPS is computed using weighted average shares outstanding plus additional shares issued as if in-the-money options and warrants were exercised (utilizing the treasury stock method).

The computation of basic and diluted earnings per share is as follows:

(IN THOUSANDS OF UNITED STATES DOLLARS, EXCEPT WEIGHTED SHARES AND PER SHARE AMOUNTS)

	THREE MONTHS ENDED	
	MARCH 31, 2005	MARCH 31,
Numerator-net earnings	$ 415	$ 1
Denominator-weighted average shares to compute basic eps	9,794,088	6,642,0
Basic eps shares	9,794,088	6,642,0
Potential dilutive from assumed exercise of stock options/warrants	1,034,103	813,0
Denominator - weighted average number of shares	10,828,191	7,455,1
Basic earnings per share	$ 0.04	$ 0.
Diluted earnings per share	$ 0.04	$ 0.

3. BUSINESS ACQUISITIONS

On March 30, 2005, the Company entered into an agreement to acquire a controlling interest in Guangzhou 3G Information Technology Co. Ltd. ("Guangzhou3G-WOFE"), through the purchase of a 51% interest of Guangzhou3G-WOFE's parent company, Pacific 3G Information & Technology Co. Limited (Guangzhou3G-BVI), a British Virgin Islands company.

PacificNet Holdings agreed to purchase 23,050 shares (the "Sale Shares") of 3G-BVI from Asiafame International Limited, Stargain International Limited and Trilogic Investments Limited, with principle place of business located in the People's Republic of China (the "Sellers"), and directly subscribed to 3G-BVI to purchase 5,000 shares (the "Subscribed Shares"). The closing of the transactions is subject to the completion of customary closing conditions, including the completion of business and financial due diligence, and is expected to occur on or prior to April 30, 2005.

The total consideration paid for the Sale Shares was payable as follows:

(i) USD$1,183,000 payable to the Sellers in cash within 30 days after the closing of the transaction;

(ii) USD$4,182,000, by delivery of 522,750 shares of common stock, par value $0.0001 per share (the "Common Stock") of PacificNet (the "PacificNet Shares") to the Sellers. The PacificNet Shares are to be held in an escrow account with an Escrow Agent designated by PacificNet Holdings. The first installment of the PacificNet Shares in the amount of 130,050 will be released 45 days after the closing of the transaction. The remaining installments will be released in equal installments of 98,175 shares within 30 days after the end of each quarter, including the quarter ended March 31, 2005, provided that Guangzhou 3G attains certain net income milestones by the end of each quarter. The Sellers will be entitled to receive all of the PacificNet Shares if Guangzhou 3G has achieved cumulative net income for the year ended December 31, 2005 of not less than USD$2,000,000. The Sellers appointed Tony Tong and Victor Tong, PacificNet's current CEO and President, respectively, as proxy for the Sellers for a period of 10 years with full power to vote the PacificNet Shares at all meetings of stockholders of the Registrant.

(iii) issuance of warrants to purchase up to 100,000 shares of the PacificNet's Common Stock. The exercise price of the warrants is the 5-Day Volume Weighted Average Price of the PacificNet's Common Stock prior to March 30, 2005. The warrant is exercisable for a period of 3 years.

PacificNet Holdings subscribed to 3G-BVI to purchase an additional 5,000 shares. The total purchase price for the Subscribed Shares is USD$500,000, payable within 45 days after the delivery of (i) stock powers transferring theSale Shares to PacificNet Holdings; (ii) stock certificates for the Sale Shares and the Subscribed Shares; (iii) an executed Subscription Agreement for the Subscribed Shares; and (iv) minutes of the Board of Directors and shareholders of Guangzhou 3G and 3G-BVI approving the transaction.

4. STOCKHOLDERS' EQUITY

For the period ended March 31, 2005, the Company issued 57,000 shares as a result of exercise of share options for cash consideration of $111,400.

Common Stock Repurchase Program.

The Company's Board of Directors has approved a Corporate Stock Repurchase Program to purchase up to US$800,000 worth of outstanding shares of its common stock in open market transactions, from time to time, in compliance with Rule 10b-18 of the Securities Exchange Act of 1934 and all other applicable securities regulations. The purpose of the repurchase program is to enhance shareholder value. During the three months ended March 31, 2005, the Company did not repurchase any shares.

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5. STOCK-BASED COMPENSATION

During the quarter ended March 31, 2005, the Company granted stock options to purchase 260,000 of the Company's common stock at $6.57 per share (based on the market price on February 25, 2005) which will expire on February 25, 2009. During the quarter ended March 31, 2005, no options were canceled or forfeited, and 57,000 options were exercised for proceeds of $111,400. As of March 31, 2005, there were 1,007,100 stock options outstanding and 490,000 options exercisable. The weighted average exercise price of the options outstanding and exercisable is $5.50 and $2.07, respectively, and the weighted average remaining contractual life is 3.50 and 1.50 and years, respectively.

The Company accounts for stock-based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," under which no compensation cost for stock options is recognized for stock option awards granted at or above fair market value. Had compensation expense for the Company's stock-based compensation plans been determined under FAS No. 123, based on the fair market value at the grant dates, the Company's pro forma net earnings (loss) and pro forma net earnings (loss) per share would have been reflected as follows at March 31:

	2005	2004
Net earnings (loss)		
As reported	$ 415	$ 141
Stock-based employee compensation cost, net of tax	(1,545)	--
Pro forma	$(1,130)	$ 141
Earnings (loss) per share		
As reported	$ 0.04	$ 0.02
Pro forma	$ (0.04)	$ 0.02

The fair value of options granted during the quarter ended March 31, 2005, was approximately $5.94 per option based on the Black-Scholes option pricing model using valuation assumptions of: a) average remaining contractual life of three years; b) expected volatility of 124.58%, c) dividend yield of 0%; and d) a risk free interest rate of 3.75%.

6. SEGMENT INFORMATION

The Company's reportable segments are operating units, which represent the operations of the Company's significant business operations. PacificNet's operations include the following three 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 Interactive Voice Response (IVR), SMS and related VAS.

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

Summarized financial information concerning the Company's reportable segments is shown in the following table. The "Other" column includes the Company's other insignificant services and corporate related items, and, as it relates to segment earnings (loss), income and expense not allocated to reportable segments.

FOR THE PERIOD ENDED MARCH 31, 2005	1. Outsourcing Business ($)	2. VAS Business ($)	3. Communications Distribution Business ($)	Admin & Ot ($)
Revenues	3,064,000	1,330,000	4,676,000	63,000
Earnings / (Loss) from Operations	239,000	580,000	129,000	(151,000

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

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE INFORMATION CONTAINED IN THE FINANCIAL STATEMENTS OF THE COMPANY AND THE NOTES THERETO APPEARING ELSEWHERE HEREIN AND IN CONJUNCTION WITH THE MANAGEMENT'S DISCUSSION AND ANALYSIS SET FORTH IN THE COMPANY'S ANNUAL REPORT ON FORM 10-KSB FOR THE YEAR ENDED DECEMBER 31, 2004.

PRELIMINARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis or plan of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to accounts receivable reserves, provisions for impairment losses of affiliated companies and other intangible assets, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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

ALLOWANCE FOR DOUBTFUL ACCOUNTS

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

INCOME TAXES - We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We have considered future market growth, forecasted earnings, future taxable income, and prudent and feasible tax planning strategies in determining the need for a valuation allowance. We currently have recorded a full valuation allowance against net deferred tax assets as we currently believe it is more likely than not that the deferred tax assets will not be realized.

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

VALUATION OF LONG-LIVED ASSETS INCLUDING GOODWILL AND PURCHASED INTANGIBLE ASSETS

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

NATURE OF THE OPERATIONS OF THE COMPANY

NATURE OF BUSINESS.

We were incorporated in the state of Delaware in 1987. Our business consists of three 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 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 VOIP, as well as mobile phone VAS, such as short messaging services (SMS) and multimedia messaging services (MMS). Recently, we commenced our communication products distribution service, through wholesale and, to a lesser extent, retail sale and distribution of calling cards in China, and we have recently invested in a company that distributes multimedia interactive self-service kiosks. 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 revenues 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 customer'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 calling card and related mobile telecom products are sold cash-on-delivery.

PacificNet's 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, TNT Express, Huawei, TCL, Dun & Bradstreet, American Express, Bank of China, DBS, Hong Kong Government, and Hongkong Post. PacificNet employs over 1000 staff in its various subsidiaries in China with offices in Hong Kong, Beijing, Shenzhen, Guangzhou, and Shandong.

RESULTS OF OPERATIONS

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

	QUARTER ENDED	
	MARCH 31,	MARCH 31,
	2005	2004
Revenues	100%	100.0%
Cost of Revenues	(81.9%)	(64.3%)
Gross Margin	18.1%	35.7%
Selling, general and administrative expense	(8.9%)	(22.2%)
Depreciation and amortization	(0.5%)	(1.9%)
Earnings from operations	8.7%	11.6%
Other income (expenses), net	1.0%	1.8%
Provision for income taxes	(0.3%)	--
Share result of associated company	(0.1%)	--
Minority interest	(4.8%)	(9.4%)
Net earnings	4.5%	4.0%

THREE MONTHS ENDED MARCH 31, 2005 COMPARED TO THREE MONTHS ENDED MARCH 31, 2004

REVENUES. Revenues for the three months ended March 31, 2005 were $9,133,000, an increase of $5,631,000 from $3,502,000 for the three months ended March 31, 2004. For the three months ended March 31, 2005, revenues of $3,064,000, $1,330,000 and $4,676,000 were derived from the services rendered by the Company's three operating units: Outsourcing Services, Value-Added Services, and Communications Products Distribution Services, respectively.

Several of our businesses experience fluctuations in quarterly performance. Traditionally, the first quarter from January to March is a low season for our call center business due to the long Lunar New Year holidays in China. Revenues from the VAS and IVR segment can vary from quarter to quarter due to new product launches and the seasonality of certain product lines.

PacificNet's operations include the following three 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 Interactive Voice Response (IVR), SMS and related VAS.

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

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

FOR THE PERIOD ENDED MARCH 31, 2005	1. Outsourcing Business ($)	2. VAS Business ($)	3. Communications Distribution Business ($)	Admin & Ot ($)
Revenues	3,064,000	1,330,000	4,676,000	63,000
Profit / (Loss) from Operations	239,000	580,000	129,000	(151,000

COST OF REVENUES. Cost of revenues for the three months ended March 31, 2005 was $7,483,000, an increase of $5,230,000 from $2,253,000 for the three months ended March 31, 2004. The increase is directly associated with the corresponding increase in revenues.

GROSS PROFIT. Gross profit for the three months ended March 31, 2005 was $1,650,000, an increase of $401,000 from $1,249,000 for the three months ended March 31, 2004. Gross margin for the three months ended March 31, 2005, was 18% of total revenues. We believe that our gross margin overall approximates the industry standards.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses totaled $810,000 for the three months ended March 31, 2005, an increase of $33,000, from $777,000 for the three months ended March 31, 2004. This increase resulted from increasing the size of our operations, which included increased premises costs and staff costs.

INCOME TAXES. Income tax provision was $24,000 for the three months ended March 31, 2005, as compared to $0 for the three months ended March 31, 2004. Interim income tax provisions are based upon management's estimate of taxable income and the resulting consolidated effective income tax rate for the full year. As a result, such interim estimates are subject to change as the year progresses and more information becomes available.

MINORITY INTERESTS. Minority interests for the three months ended March 31, 2005 totaled $(443,000), compared with $(328,000) for the same period in the prior year, which represents the outside ownership interest in a subsidiary that is consolidated with the parent for financial reporting purposes.

LIQUIDITY AND CAPITAL RESOURCES

CASH AND CASH EQUIVALENTS. As of March 31, 2005, the Company had cash and cash equivalents of $2,323,000 as compared to $6,764,000 at December 31, 2004.

WORKING CAPITAL. The Company's working capital decreased to $16,016,000 at March 31, 2005, as compared to $ 16,185,000 at December 31, 2004. When compared to balances at December 31, 2004, the minimal decrease in working capital at March 31, 2005 was primarily due to overall net decreases in the working capital accounts resulting from reductions in cash used for payments on accounts payable and accrued liabilities and banking loans.

NET CASH FROM OPERATING ACTIVITIES. Net cash used in operating activities was $3,638,000 for the three months ended March 31, 2005 as compared to net cash used in operating activities of $1,040,000 for the three months ended March 31, 2004. Net cash used in operating activities in the three months ended March 31, 2005 was primarily due to advances to related entities of $876,000, prepayment for planned purchase of office in Beijing for $300,000, payments made to reduce liabilities such as accounts payable and accrued expenses of $1,483,000 and banking loans of $836,000, and purchases of inventories of $430,000 to respond to future demand for our products.

NET CASH FROM INVESTING ACTIVITIES.

NET CASH FROM FINANCING ACTIVITIES. Net cash used in financing activities for the three months ended March 31, 2005 was $597,000 representing repayment of banking facilities of $836,000 primarily by EPRO, dividend paid out of $339,000 to minority interest shareholders by Linkhead, and cash received of $111,400 from the exercise of 57,000 share options. Net cash provided by financing activities for the three months ended March 31, 2004 was $1,701,000, which was primarily a result of common stock sold for cash of $2,868,000 offset by net repayments on banking loans of $1,167,000.

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

CURRENCY EXCHANGE FLUCTUATIONS. All of the Company's revenues are denominated either in U.S. dollars or Hong Kong dollars, while its expenses are denominated primarily in Hong Kong dollars and Renminbi ("RMB"), the currency of the

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

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

CONTRACTUAL OBLIGATIONS

CONTRACTUAL OBLIGATIONS. We have significant cash resources to meet our contractual obligations as of March 31, 32005, as detailed below:

Payments Due by Period

Contractual Obligations	Total	Less than 1 year	1-3 years	4-5 years	A
Line of credit	$ 69,000	$ 69,000	--	--	
Bank Loans	$ 1,112,000	$ 1,035,000	$ 77,000	--	
Operating leases	$ 104,000	$ 104,000	--	--	
Capital leases	$ 239,000	$ 113,000	$ 126,000	--	
Total cash contractual obligations	$ 1,524,000	$ 1,321,000	$ 203,000		

CONCENTRATION OF CREDIT RISK. All of the Company's revenues are derived in Asia and Greater China. The Company does not have any single customer that accounts for more than 10% of its revenues or 10% of its purchases. If the Company was unable to derive any revenue from Asia and Greater China, it would have a significant, financially disruptive effect on the normal operations of the Company. Based on the current economic environment in China, the Company does not expect any material adverse impact to its business, financial condition and results of operations.

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

ITEM 3. CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including our principal executive officer and the principal accounting officer, the Company conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this report (the "Evaluation Date"). Based on this evaluation, the Company's principal executive officer and principal accounting officer concluded as of the Evaluation Date that the Company's disclosure controls and procedures were effective such that the material information required to be included in our Securities and Exchange Commission ("SEC") reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to the Company, including our consolidating subsidiaries, and was made known to them by others within those entities, particularly during the period when this report was being prepared.

Additionally, there were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the Evaluation Date. We have not identified any significant deficiencies or material weaknesses in our internal controls, and therefore there were no corrective actions taken.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

None.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS

EXHIBITS

The following exhibits are filed as part of this report:

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

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SIGNATURES

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

PACIFICNET INC.

Date: May 15, 2005

By: /s/ TONY TONG

Tony Tong
Chief Executive Officer
(Principal Executive Officer)

Date: May 15, 2005

By: /s/ WANG SHAO JIAN

Wang Shao Jian
Chief Financial Officer
(Principal Financial Officer)

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