

PACIFICNET INC
Form 424B3
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Registration Statement No. 333-134127

PROSPECTUS

PACIFICNET INC.

3,152,228 Shares of Common Stock

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

Our shares of common stock are traded on The Nasdaq Global Market under the symbol "PACT." The last reported sale price of our common stock on December 5, 2006, was \$4.74.

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

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

The date of this prospectus is December 8, 2006.

TABLE OF CONTENTS

	<u>Page</u>
<u>PROSPECTUS SUMMARY</u>	1
<u>RISK FACTORS</u>	5
<u>USE OF PROCEEDS</u>	13
<u>SELLING STOCKHOLDERS</u>	13
<u>PLAN OF DISTRIBUTION</u>	16
<u>SELECTED FINANCIAL DATA</u>	18
<u>SUPPLEMENTARY FINANCIAL INFORMATION</u>	19
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	20
<u>BUSINESS</u>	35
<u>MANAGEMENT</u>	58
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT</u>	60
<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS</u>	60
<u>MARKET FOR OUR COMMON STOCK, DIVIDENDS AND RELATED STOCKHOLDER INFORMATION</u>	60
<u>DESCRIPTION OF CAPITAL STOCK</u>	61
<u>TRANSFER AGENT AND REGISTRAR</u>	62
<u>LEGAL MATERS</u>	62
<u>EXPERTS</u>	62
<u>WHERE YOU CAN FIND MORE INFORMATION</u>	62
<u>INDEX TO CONSOLIDATED FINANCIAL STATEMENTS</u>	F-1

PROSPECTUS SUMMARY

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

About PacificNet Inc.

We were incorporated in the state of Delaware in 1987. We are a leading provider of customer relationship management (CRM) and telecom services, e-commerce and gaming technology in China. 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, and one group that focuses on primarily administrative and corporate related matters. Through our subsidiaries we provide outsourcing services, telecom (VAS) services, and products (telecom & gaming) services. Our business process outsourcing (BPO) services include call centers providing 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). In 2004, we commenced our communication products distribution service, through wholesale and, to a lesser extent, retail sale and distribution of mobile phones, software and hardware, mobile accessories, and calling cards in Hong Kong and China. In 2005, we invested in Take1Technologies (formerly known as Cheer Era), a company that designs, manufactures, and distributes multimedia interactive self-service kiosks, bingo and gaming machines for the casino and slot machine operators Europe and Asia.

Our BPO 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 gaming center operations generate revenue through the sale of gaming machines to casinos, or through resellers who sell to casinos.

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 2,300 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 BPO, call center, IT Outsourcing (ITO) and software development services.
- (2) Telecom Value-added Services: including Content Providing (CP), IVR, Platform Providing (PP) and Service Providing (SP).
- (3) Products (Telecom & Gaming): including communication and gaming products, GSM/CDMA/3G Products and Multimedia Communication Kiosks.
- (4) Other Business: including internal administrative matters, other related corporate items, and other businesses.

Private Placement of Convertible Debentures and Warrants

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

Under the terms of the registration rights agreement, dated February 28, 2006, entered into among the Company and the holders, we are obligated to register for resale 150% of the shares of common stock issuable upon conversion of the debentures and the warrants, and interest on the convertible debentures. We are currently in default under the private placement transaction documents for the untimely filing of the registration statement, of which this prospectus is part, and for the failure to have the registration statement declared effective prior to the effectiveness date set forth in the registration rights agreement. As of November 1, 2006, we could be liable for liquidated damages of approximately \$800,000 as a result of the foregoing. As of the date of this prospectus, we have paid \$35,000 in liquidated damages to one holder. As of the date of this prospectus the holders have not elected to accelerate the payment of the outstanding principal and interest owing on the debenture.

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

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

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

RECENT DEVELOPMENTS

Unwinding of Business Acquisition

On December 19, 2005, we announced the execution by our wholly-owned subsidiary, PacificNet Strategic Investment Holdings Limited ("PacInvest"), of an Agreement for the Sale and Purchase of 100% of Lion Zone Holdings Limited (the "Sale and Purchase Agreement"). Pursuant to the terms of the Sale and Purchase Agreement, PacInvest acquired a 51% interest in Lion Zone Holdings Limited ("Lion Zone"), which holds a 100% interest in Shenzhen GuHaiGuanChao Investment Consultant Co., Ltd. ("ChinaGoHi"), a wholly-owned foreign enterprise (WOFE) registered in China and a provider of DRTV infomercial marketing company for financial advisory services in China.

On November 20, 2006, PacInvest executed an agreement to terminate (the "Termination Agreement"), the Sale and Purchase Agreement with Lion Zone, ChinaGoHi and Mr. Wang Wenming (collectively, the "Sellers"). The Termination Agreement was effective as of November 1, 2006. As a result of the Termination Agreement, Mr. Wang Wenming and Lion Zone agreed to return to PacInvest, (1) HKD\$3,000,000, (2) USD\$100,000 in cash, and (3) 275,000 of our restricted shares, and PacInvest returned its 51% interest in Lion Zone to Mr. Wang. Additionally, the Sellers agreed to waive PacInvest's obligation during the term of the Sale and Purchase Agreement to issue the restricted shares and to provide certain loans to the Sellers. PacInvest reserved its right to re-purchase the 51% interest within 2 years of the date of signing the Termination Agreement for a purchase price of 5 times net profit based on U.S. GAAP audited financials for a period of 12 months after signing. All of the parties to the Termination Agreement agreed to waive any liabilities of each party which may result from the Termination Agreement.

The decision to terminate the Sale and Purchase Agreement was due to ChinaGoHi's inability to obtain the approval of, and get the necessary license to operate from, the China Securities Regulatory Commission ("CSRC"). We have previously disclosed in our periodic reports filed with the Securities and Exchange Commission that in the past, the Chinese government has stopped the distribution of information that it believes violates PRC law over the Internet or through VAS. We have disclosed the risk that if the PRC government were to take any action to limit or prohibit the distribution of information through our networks 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. In July 2006, the Chinese Broadcasting Bureau along with the CSRC banned the TV membership sales model, which was the model ChinaGoHi employed in its business. The Sale and Purchase Agreement provided that if ChinaGoHi or Lion Zone was banned or in any way restricted from conducting business under the existing or new PRC laws or legislation during the period from signing the Sale and Purchase Agreement to July 1, 2006, and ChinaGoHi failed to change its business model in good faith to adapt to the new regulations, and such failure resulted in any shortcoming of the accumulated net profit, ChinaGoHi and Lion Zone would return to PacInvest all the cash and shares they obtained under the Agreement.

Business Acquisition

In August 2006, PacificNet Games Limited (PacGames) completed the acquisition of 100% of Able Entertainment Technology Ltd, a leading provider of Asian multi-player electronic gaming machines, gaming technology solutions and gaming related maintenance, IT and distribution services for the leading hotel, casino and slot hall operators based in Macau, China and other Asian gaming markets. Macau is expected to surpass Las Vegas in total revenues by 2006. Currently, table games make up the bulk of Macau casino revenues, which is in sharp contrast to other areas such as Las Vegas. With this acquisition, PacGames is a leading developer of electronic versions of these popular table games which are less expensive to run resulting in higher casino profits with great appeal to the mass market players. Further, the growing market in Macau is for Asian table games such as Baccarat, Roulette, Fan Tan, Fish-Prawn-Crab and Sic-Bo Cussec as these games have wider acceptance in the Asian market than Western games such as poker or slots. The development, manufacturing, maintenance, and service of electronic Asian table games are underserved areas which are predicted to grow considerably as Macau's gaming market matures. PacGames products include multi-play

electronic gaming machines such as Baccarat, Fish-Prawn-Crab, Sib-Bo Cussec, Roulette, and Video Lottery Terminals (VLT) such as Keno and Bingo, as well as other traditional slot machines. 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.

SUMMARY CONSOLIDATED FINANCIAL DATA

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

CONSOLIDATED STATEMENT OF OPERATIONS DATA

	Nine months ended September 30,		Year Ended December 31,				
	2006(unaudited)	2005(unaudited) (as restated)	2005 (as restated)	2004	2003 (as restated)	2002	2001
Statement of Operations Data:	(in thousands, except per share data)						
Revenues	\$ 47,239	\$ 32,539	\$ 44,341	\$ 29,709	\$ 1,217	\$ 2,319	\$ 961
Cost of revenues	(33,352)	(25,979)	(33,439)	(24,074)	(698)	(1,787)	(803)
Gross margin	13,887	6,560	10,902	5,635	519	532	158
Operating expenses: selling, general and administrative	(11,599)	(3,536)	(6,104)	(3,513)	(1,856)	(3,176)	(4,044)
Interest expense	(851)	(182)	(229)	(185)	-	-	-
Earnings/(Loss) from operations	1,437	2,842	4,569	1,937	(1,337)	(2,644)	(3,886)
Interest income	177	155	246	79	27	33	187
Other income	173	577	830	422	54	-	-
Liquidated damages expense	(800)	-	-	-	-	-	-
Changes in fair value of derivatives	1,212	-	-	-	-	-	-
Provision for impairment losses in affiliated companies	-	-	-	-	-	(97)	(1,093)
Earnings before income tax, minority interests and discontinued operations	2,199	3,574	5,645	2,438	(1,256)	(2,708)	(4,792)
Provision for Income Tax	(319)	(51)	(222)				