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

FORM 10-Q

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from ___________ to _____________

Commission File Number: **000-28063**

deltathree, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware	**13-4006766**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
1 Bridge Plaza, Fort Lee, New Jersey	**07024**
(Address of principal executive offices)	**(Zip Code)**

(212) 500-4850
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐	Accelerated filer ☐
Non-accelerated filer ☐	Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of August 5, 2014, the registrant had outstanding 72,311,025 shares of common stock, par value $0.001 per share.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

DELTATHREE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
($ in thousands)

	As of June 30, 2014	As of December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 154	$ 158
Restricted cash and short-term investments	4	34
Accounts receivable, net	757	541
Prepaid expenses and other current assets	235	271
Inventory	22	22
Total current assets	1,172	1,026
Property and equipment, net	125	164
Deposits	89	87
Total assets	$ 1,386	$ 1,277
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable – trade	1,134	984
Accounts payable – related party	1,531	1,286
Deferred revenues	174	203
Short-term loan from a related party	4,971	4,960
Other current liabilities	1,097	1,116
Total current liabilities	8,907	8,549
Long-term liabilities:		
Severance pay obligations	140	105
Total long-term liabilities	140	105
Total liabilities	9,047	8,654
Stockholders' deficiency:		
Share capital:		
Common stock, par value $0.001 per share; authorized: 225,000,000 shares; issued and outstanding: 72,311,025 at June 30, 2014, and 72,273,525 at December 31, 2013	72	72
Additional paid-in capital	177,828	177,315
Accumulated deficit	(185,561)	(184,764)
Total stockholders' deficiency	(7,661)	(7,377)
Total liabilities and stockholders' deficiency	$ 1,386	$ 1,277

See notes to unaudited condensed consolidated financial statements.

DELTATHREE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
($ in thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Revenues	$ 4,391	$ 4,216	$ 8,710	$ 7,946
Costs and operating expenses:				
Cost of revenues	3,688	3,425	7,236	6,218
Research and development expenses	235	295	510	588
Selling and marketing expenses	175	319	399	712
General and administrative expenses	350	350	680	701
Depreciation and amortization	25	37	50	76
Total costs and operating expenses	4,473	4,426	8,875	8,294
Loss from operations	(82)	(210)	(165)	(348)
Interest expense, net	(379)	(198)	(621)	(405)
Loss before income taxes	(461)	(408)	(786)	(753)
Income taxes	5	6	11	17
Net loss	$ (466)	$ (414)	$ (797)	$ (770)
Net loss per share – basic and diluted	$ (0.01)	$ (0.01)	$ (0.01)	$ (0.01)
Basic and diluted weighted average number of shares outstanding	72,311,025	72,273,525	72,295,400	72,273,525

See notes to unaudited condensed consolidated financial statements.

DELTATHREE, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
($ in thousands)

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Cash flows from operating activities:		
Net loss for the period	$ (797)	$ (770)
Adjustments to reconcile loss for the period to net cash (used in) operating activities:		
Accumulated interest on short-term loan	330	272
Depreciation and amortization	50	76
Amortization related to convertible notes	179	80
Stock-based compensation	14	55
Increase in liability for severance pay, net	35	-
Exchange rates differences on deposits, net	(2)	(3)
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(216)	19
Decrease in prepaid expenses and other current assets	36	35
Increase in inventory	-	10
Increase in accounts payable	395	208
(Decrease) in deferred revenues	(29)	(172)
(Decrease) increase in other current liabilities	(19)	80
	773	660
Net cash (used in) operating activities	(24)	(110)
Cash flows from investing activities:		
Purchase of property and equipment	(11)	(58)
Release of restricted cash and short-term investment, net	30	10
Net cash provided by (used in) investing activities	19	(48)
Cash flows from financing activities:		
Proceeds from exercise of options	1	-
Net cash provided by financing activities	1	-
(Decrease) in cash and cash equivalents	(4)	(158)
Cash and cash equivalents at beginning of period	158	362
Cash and cash equivalents at end of period	$ 154	$ 204

	Six Months Ended June 30,	
	2014	**2013**
Supplemental schedule of cash flow information:		
Cash paid for:		
Taxes	11	36
Total	$ 11	$ 36

	Six Months Ended June 30,	
	2014	**2013**
Non cash activity:		
Issuance of warrants against short-term loan	$ 498	-

See notes to unaudited condensed consolidated financial statements.

DELTATHREE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation

Financial Statement Preparation

The unaudited condensed consolidated financial statements of deltathree, Inc. and its subsidiaries (collectively referred to in this Quarterly Report on Form 10-Q as the "Company", "we", "us", or "our"), of which these notes are a part, have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of our management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation of the financial information as of and for the periods presented have been included.

The results for the interim periods presented are not necessarily indicative of the results that may be expected for any future period. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2013, included in our Annual Report on Form 10-K filed with the SEC on March 31, 2014, our Quarterly Report on Form 10-Q filed with the SEC on May 13, 2014, and all of our other periodic filings, including Current Reports on Form 8-K, filed with the SEC after the end of our 2013 fiscal year and through the date of this Report.

Going Concern

The Company has sustained significant operating losses in recent periods, which has resulted in a significant reduction in its cash reserves. The Company and its subsidiaries have entered into four loan agreements with D4 Holdings, LLC, its majority stockholder, pursuant to which D4 Holdings has agreed to provide the Company with loans in the aggregate principal amount of $4,100,000.

On March 1, 2010, the Company and its subsidiaries entered into a Loan and Security Agreement, or the "First Loan Agreement", with D4 Holdings pursuant to which D4 Holdings agreed to provide the Company and its subsidiaries a line of credit in a principal amount of $1,200,000. On August 10, 2010, the Company and its subsidiaries entered into the Second Loan and Security Agreement, or the "Second Loan Agreement", with D4 Holdings, pursuant to which D4 Holdings agreed to provide the Company and its subsidiaries an additional line of credit in a principal amount of $1,000,000. In connection with the Second Loan Agreement, the Company issued to D4 Holdings a warrant to purchase up to 4,000,000 shares of its common stock at an exercise price of $0.1312 per share. The Company has drawn down all amounts available to be borrowed under the two lines of credit.

On March 2, 2011, the Company and its subsidiaries entered into the Third Loan and Security Agreement, or the "Third Loan Agreement", with D4 Holdings, pursuant to which D4 Holdings agreed to provide the Company and its subsidiaries an additional line of credit in a principal amount of $1,600,000. Pursuant to the terms of the Convertible Promissory Note, or the "Convertible Note", issued by the Company in connection with the Third Loan Agreement, D4 Holdings may elect to convert all or any portion of the outstanding principal amount under the Convertible Note into that number of shares of the Company's common stock determined by dividing such principal amount by $0.08 (as may be adjusted under the terms of the Convertible Note). Simultaneous with the Company's entering into the Third Loan Agreement, D4 Holdings and the Company and its subsidiaries entered into an amendment of the First Loan Agreement, pursuant to which (among other things) the maturity date for repayment of principal under the First Loan Agreement was extended from March 1, 2011, to March 1, 2012, and subsequently extended by oral agreement of the parties to July 1, 2012, and then subsequently orally extended again to January 2, 2014, pending the parties finalizing and entering into a formal amendment. In connection with the Third Loan Agreement, the Company issued D4 Holdings a warrant to purchase up to 1,000,000 shares of the Company's common stock at an exercise price of $0.096 per share. The Company has drawn down the aggregate principal amount available under the Third Loan Agreement, the principal amount of which can be converted by D4 Holdings into an aggregate of 20,000,000 shares of the Company's common stock.

On September 12, 2011, the Company and its subsidiaries entered into the Fourth Loan and Security Agreement, or the "Fourth Loan Agreement", with D4 Holdings, pursuant to which D4 Holdings agreed to provide the Company and its subsidiaries an additional line of credit in a principal amount of $300,000. The Company has drawn down all amounts available to be borrowed under the Fourth Loan Agreement.

On November 13, 2012, the Company and its subsidiaries entered into the Third Amendment to Loan and Security Agreements, or the "Third Amendment", and the Amendment to Warrant Agreements, or the "Warrants Amendment", with D4 Holdings. Pursuant to the Third Amendment and the Warrants Amendment:

- the maturity date for repayment of principal and interest under the First Loan Agreement was extended to January 2, 2014;
- the maturity date for repayment of principal and interest under the Second Loan Agreement was extended to January 2, 2015;
- the maturity date for repayment of principal and interest under each of the Third and Fourth Loan Agreements was extended to January 2, 2016;
- all interest outstanding under each of the loan agreements was added to the principal amount outstanding under the respective loan agreement and the promissory notes issued pursuant to each respective loan agreement was increased by such amount; and
- the exercise price under each of the Warrant Agreements entered into by the Company and D4 Holdings as of February 12, 2009, August 10, 2010, and March 2, 2011 was amended to $0.02 per share.

In connection with the extension of the maturity dates under the Third Amendment, the Company issued to D4 Holdings a warrant, exercisable for ten years, to purchase up to 10,000,000 shares of the Company's common stock at an exercise price of $0.02 per share.

On January 2, 2014, the Company did not repay to D4 Holdings the outstanding principal and interest due under the First Loan Agreement, which constituted an event of default thereunder and a cross-default under all our other loan agreements with D4 Holdings. On March 28, 2014, the Company and its subsidiaries entered into a Forbearance Agreement with D4 Holdings, or the "D4 Holdings Forbearance Agreement". Pursuant to the terms and conditions of the D4 Holdings Forbearance Agreement, D4 Holdings agreed to forbear from taking any action with respect to the events of default until the earlier of (i) December 31, 2014, (ii) the occurrence of a breach or default by the Company or its subsidiaries under the D4 Holdings Forbearance Agreement (which, in the event of certain undertakings of the Company's under the D4 Holdings Forbearance Agreement, are not cured within three days) or (iii) the occurrence of any new or additional event of default under the Company's loan agreements with D4 Holdings. In addition, to the extent not yet perfected the Company and its subsidiaries pledged and granted as a security interest to D4 Holdings all of their right, title and interest in the collateral described in the D4 Holdings Forbearance Agreement. In connection with the D4 Holdings Forbearance Agreement the Company also issued to D4 Holdings a warrant, exercisable for ten years, to purchase up to 10,000,000 shares of our common stock at an exercise price of $0.02 per share.

On June 12, 2014, each of the Company and its wholly-owned subsidiaries Delta Three Israel, Ltd., or "Delta Three Israel", and DME Solutions, Inc., or "DME", and together with the Company and Delta Three Israel, the "deltathree Entities", and ACN, Inc., or "ACN", ACN Europe B.V., or "ACN Europe", ACN Digital Phone Service, LLC, or "ACN Digital Phone Service", and together with ACN, Inc. and ACN Europe, the "ACN Entities", entered into the Amended and Restated Agreement Concerning Outstanding/Future Commissions and Security Agreement, or the "ACN Forbearance Agreement". The ACN Forbearance Agreement amends that certain letter amendment, dated as of April 3, 2012, to each of the Sales Agency Agreement dated as of September 27, 2010, and amended as of January 26, 2011, or the "Sales Agency Agreement", between the deltathree Entities and ACN, and the Introducer Agreement, dated as of April 13, 2011, between the deltathree Entities and ACN Europe B.V., or the "Introducer Agreement", in regards to outstanding commissions due to be paid by the Company to ACN and ACN Europe under those agreements. The ACN Forbearance Agreement also amends that certain License Assignment entered into on February 7, 2013 between the Company and DPS and the outstanding license assignment payment due to be paid by the Company to DPS.

The terms of the ACN Forbearance Amendment provide as follows:

- commencing with the date of the ACN Forbearance Agreement, a late fee in the amount of one percent (1%) per month will accrue on any unpaid commissions and the license assignment payment, and commencing on July 15, 2014, and continuing on the 15th day of each month thereafter the deltathree Entities will pay to ACN and ACN Europe the interest that accrued during the previous month;
- in addition, commencing on July 15, 2014, and continuing on the 15th day of each month thereafter, the deltathree Entities will (i) pay down any outstanding obligations, provided that the amount of each monthly payment will be equal to at least $114,000, and (ii) pay all then-current commissions under the Sales Agency Agreement and Introducer Agreement and any cure periods provided for under the respective agreements for non-payment will no longer apply;
- so long as the deltathree Entities fulfill the terms of the ACN Forbearance Agreement, the ACN Entities will forbear from exercising any rights they may have for any breach by the deltathree Entities under the Sales Agency Agreement and the Introducer Agreement and permit the Company to pay the license assignment payment over time in accordance with the terms and conditions of the ACN Forbearance Agreement until July 31, 2014, or the "Initial Forbearance Period". Upon the expiration of the Initial Forbearance Period, the ACN Entities' obligation to forbear will automatically renew on a monthly basis unless terminated by either party under the terms of the ACN Forbearance Agreement until July 15, 2015, following which such the ACN Entities' obligation to forbear will not automatically renew;

- upon the expiration of the Initial Forbearance Period or any subsequent renewals, unless the ACN Entities' requirement to forbear is renewed, all unpaid obligations will become immediately due and payable;
- each of Delta Three Israel and DME guaranteed the payment and performance of the Company's obligations under the license assignment and under the ACN Forbearance Agreement;
- to secure the payment and performance in full of all of their obligations under the agreement, the deltathree Entities granted to the ACN Entities a continuing security interest in, and pledged to the ACN Entities, all of their right, title and interest in, to and under the collateral set forth on Exhibit A of the ACN Forbearance Agreement; and
- in the event of any Event of Default (as defined in the ACN Forbearance agreement), all unpaid amounts due from the deltathree Entities will become immediately due and payable and the ACN Entities may in their sole discretion terminate the ACN Forbearance Agreement and exercise their rights and pursue all remedies available to them as a secured creditor and at law or in equity.

The Company did not make the payments it was required to make to the ACN Entities on July 15, 2014, described in the first and second bullet points above and is currently in default under the ACN Forbearance Agreement.

As of June 30, 2014, the Company had negative working capital equal to approximately $7.7 million as well as negative stockholders' equity equal to approximately $7.7 million. The Company believes it is probable that it will continue to experience losses and increased negative working capital and negative stockholders' equity in the near future and will not be able to return to positive cash flow before it requires additional cash in the immediate term. The Company may experience difficulties accessing the equity and debt markets and raising additional capital, and there can be no assurance that the Company will be able to raise such additional capital on favorable terms or at all. If additional funds are raised through the issuance of equity securities, the Company's existing stockholders will experience significant further dilution. Because of the Company's significant losses to date and the Company's limited tangible assets, the Company does not fit traditional credit lending criteria, which could make it difficult for the Company to obtain loans or to access the capital markets. If the Company issues additional equity or convertible debt securities to raise funds, the ownership percentage of the Company's existing stockholders would be reduced and they may experience significant dilution. New investors may demand rights, preferences or privileges senior to those of existing holders of the Company's common stock

The Company believes that, unless it is able to increase revenues and generate additional cash, its current cash and cash equivalents will not satisfy its current projected cash requirements beyond the immediate future. As a result, there is substantial doubt about the Company's ability to continue as a going concern.

In addition, unless the Company is able to increase revenues and generate additional cash flows, based on currently projected cash flows the Company believes that it will be unable to pay future scheduled interest and/or principal payments under the various loan agreements with D4 Holdings as these obligations become due, and beginning January 2013 the Company suspended making scheduled interest payments with the oral consent of D4 Holdings. On January 2, 2014, the Company did not repay to D4 Holdings the outstanding principal and interest due under the First Loan Agreement, which constituted an event of default thereunder and a cross-default under all the Company's other loan agreements with D4 Holdings, following which the Company and its subsidiaries entered into the D4 Holdings Forbearance Agreement. In the event the Company is unable to resume making interest payments and to pay the outstanding principal when due following the termination of the D4 Holdings Forbearance Agreement, if D4 Holdings is not willing to waive compliance or otherwise modify our obligations such that the Company is able to avoid defaulting on such obligations, because D4 Holdings has a lien on all of the Company's assets to secure our obligations under the loan agreements it could take actions under the loan agreements and seek to take possession of or sell the Company's assets to satisfy the Company's obligations thereunder. Any of these actions would likely have an immediate material adverse effect on the Company's business, financial condition or results of operations.

Due to the Company's ongoing losses and reduction in cash, the Company initiated restructuring activities beginning in the second quarter of 2011 in an effort to cut operating costs significantly and better align the Company's operations with its current business model. In accordance with the restructuring, the Company instituted a reduction in force and decreased the number of full time employees from approximately 53 to 32, reduced the salaries of all remaining employees by five percent, and decreased non-material expenses as well as payments to be made to vendors and other third parties. In addition, in December 2013 the Company instituted an additional, smaller reduction in force. As of June 30, 2014, the Company had 13 full time employees. During March 2014, as an incentive for the Company's remaining employees the Company reversed the five-percent reduction in salaries that it instituted in 2011.

In view of the Company's current cash resources, nondiscretionary expenses, debt and near term debt service obligations, the Company has begun exploring strategic alternatives available to it and may explore all such alternatives available to it, including, but not limited to, a sale or merger of the Company, a sale of its assets, recapitalization, partnership, debt or equity financing, voluntary deregistration of its securities, financial reorganization, liquidation and/or ceasing operations. In the event that the Company requires but is unable to secure additional funding, the Company may determine that it is in its best interests to voluntarily seek relief under Chapter 11 of the U.S. Bankruptcy Code. Seeking relief under the U.S. Bankruptcy Code, even if the Company is able to emerge quickly from Chapter 11 protection, could have a material adverse effect on the relationships between the Company and its existing and potential customers, employees, and others. Further, if the Company was unable to implement a successful plan of reorganization, the Company might be forced to liquidate under Chapter 7 of the U.S. Bankruptcy Code. There can be no assurance that exploration of strategic alternatives will result in the Company pursuing any particular transaction or, if the Company pursues any such transaction, that it will be completed.

Use of Estimates

The Company's consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States, which require management to make estimates and assumptions that affect the amounts reported and disclosed in the consolidated financial statements and the accompanying notes. Actual results could differ materially from these estimates.

Concentration of Credit and Business Risks

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents and trade accounts receivable. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history, age of the balance and the customer's current credit worthiness, as determined by a review of the customer's current credit information. The Company monitors collections and payments from its customers and maintains an allowance for doubtful accounts based upon historical experience and any specific customer collection issues that have been identified. A considerable amount of judgment is required in assessing the ultimate realization of these receivables. Customer receivables are generally unsecured.

Gross revenues from sales to material customers for each of the three months ended June 30, 2014 and 2013, and accounts receivables as of June 30, 2014, and December 31, 2013, were as follows:

	Revenues		Accounts Receivable	
	Three Months Ended June 30,		As of	
Customer	**2014**	**2013**	**June 30, 2014**	**December 31, 2013**
Reseller A	71%	68%	55%	34%
Reseller B	1%	5%	9%	13%
Affiliate A	1%	2%	-%	-%
Affiliate B	2%	4%	-%	-%
Service Provider A	4%	4%	12%	17%

Earnings per Common Share

Basic earnings per common share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during the reporting period. Diluted earnings per common share is computed by dividing net income by the combination of dilutive common share equivalents, comprised of shares issuable under the Company's stock option and stock incentive compensation plans, and the weighted-average number of shares of common stock outstanding during the reporting period. Dilutive common share equivalents include the dilutive effect of in-the-money shares, which is calculated based on the average share price for each period using the treasury stock method. Under the treasury stock method, the exercise price of a share, the amount of compensation cost, if any, for future service that the Company has not yet recognized, and the amount of estimated tax benefits that would be recorded in additional paid-in capital, if any, when the share is exercised are assumed to be used to repurchase shares in the current period.

2. Commitments and Contingencies

Pursuant to an Assignment and Assumption of Rights, Duties and Interests Agreement between the Company and ACN Digital Phone Services, ACN Digital assigned to the Company (the "Assignment") the licenses it acquired pursuant to that certain Software License and Distribution Agreement, or the "CounterPath Agreement", between ACN Digital and CounterPath Corporation, or "CounterPath", subject to the finalization of the terms of the Assignment. On August 27, 2013, the Company's Board of Directors resolved that the consideration, or the "Consideration", to be paid by the Company to ACN Digital for the Assignment would be equal to $287,000, which ACN Digital informed us was equal to ACN Digital's cost under the CounterPath Agreement, and finalized the terms of the Assignment. Pursuant to a Reassignment and Assumption of Rights, Duties and Interests Agreement entered into between the Company and ACN Digital on March 13, 2014, the Company reassigned to ACN Digital most of the licenses the Company had received pursuant to the Assignment and the amount of the Consideration was reduced to $113,000.

The amount of the Consideration was added to the outstanding amounts owed by the Company to ACN under, and is to be paid in accordance with, the Sales Agency Agreement between (inter alia) the Company and ACN dated September 27, 2010, as amended by that certain Letter Amendment, dated as of April 3, 2012, and by the ACN Forbearance Agreement.

Lease Commitments

The Company leases its executive offices at 1 Bridge Plaza, Fort Lee, New Jersey, and storage and equipment space at 8301 River Road, North Bergen New Jersey. The Company leases each of these facilities on a month-to-month basis. The aggregate rent expense, net, for the two locations for the three months ended June 30, 2014, was $1,800.

Delta Three Israel leases an office that houses the Company's research and development facilities in Jerusalem, Israel. The term of the lease is until June 30, 2016. Rent expense, net for Delta Three Israel for the three months ended June 30, 2014, was $37,500.

Legal Proceedings

On July 5, 2011, the Company received a notice from the New York City Department of Finance, or the Department of Finance, which claimed that the Company had not paid commercial rent tax required under the New York City Administrative Code from June 1998 through May 2008 for the two offices that the Company had leased during that time. The notice stated that the Company is obligated to pay the outstanding tax amounts, as well as significant interest and penalties that were assessed on the unpaid amounts as well as for the failure to file the applicable tax returns. The Company engaged outside counsel, which began discussions with the Department of Finance, and contested the assessment and simultaneously attempted to negotiate a significant reduction in the amounts to be paid. The Company's appeal was rejected in July 2012 by an examiner in the Department of Finance, and the Company has subsequently engaged and begun discussions with a manager in the Department of Finance and submitted additional supporting materials. In June 2013 the Company submitted a settlement offer, which the Department of Finance did not accept, and discussions are continuing. The final outcome of this assessment and the Company's negotiations with the Department of Finance cannot be determined at this time. In the event that the Company is required to pay all or most of the amounts claimed by the Department of Finance this would have a material adverse effect on the Company's financial condition. During 2011 the Company recorded $300,000 as a provision for commercial rent tax.

On May 1, 2014, the Company was informed that a complaint had been filed in the United States District Court for the Eastern District Court of Texas by Telinit Technologies, LLC against the Company, ACN, and ACN Communication Services claiming infringement of a patent claimed to be owned by Telinit. The Company was provided with a copy of the complaint but has not been formally served. The Company is currently investigating the matter and reviewing the alleged complaint. During the second quarter of 2014 the Company recorded a provision for the complaint.

In addition, from time to time the Company is a party to legal proceedings, much of which is ordinary routine litigation incidental to the business, and is regularly required to expend time and resources in connection with such proceedings. Accordingly, the Company, in consultation with its legal advisors, accrues amounts that management believes it is probable the Company will be required to expend in connection with all legal proceedings to which it is a party.

Regulatory Taxes, Fees and Surcharges

Some state and local regulatory authorities believe they retain jurisdiction to regulate the provision of, and impose taxes, fees and surcharges on, intrastate Internet and VoIP telephony services, and have attempted to impose such taxes, fees and surcharges, such as a fee for providing E-911 service. Rulings by the state commissions on the regulatory considerations affecting Internet and IP telephony services could affect our operations and revenues, and we cannot predict whether state commissions will be permitted to regulate the services we offer in the future.

The Company paid approximately $5,000 of state and local taxes and other fees during the three months ended June 30, 2014. To the extent the Company increases the cost of services to our customers to recoup some of the costs of compliance this will have the effect of decreasing any price advantage the Company may have over traditional telecommunications companies.

In addition, it is possible that the Company will be required to collect and remit taxes, fees and surcharges in other states and local jurisdictions where it has not done so, and which such authorities may take the position that it should have collected. If so, they may seek to collect those past taxes, fees and surcharges from the Company and impose fines, penalties or interest charges on the Company. The Company's payment of these past taxes, fees and surcharges, as well as penalties and interest charges, could have a material adverse effect on the Company.

3. **Warrants and Convertible Note**

We accounted for the Second Loan Agreement and the Third Loan Agreement in accordance with "Debt with Conversion and Other Options" [ASC 470-20-25]. We accounted for the Second Loan Agreement as a debt instrument with stock warrants. Under ASC 470-20-25, issuers of certain debt instruments with stock warrants are required to separately account for the liability components and the equity components based on the relative fair value of the debt instrument without the warrants and of the warrants themselves at the time of issuance, which the Company did.

We accounted for the Third Loan Agreement as a convertible debt instrument with stock warrants and a beneficial conversion features. As required under ASC 470-20-25, the Company separated the debt instruments and the warrants based on their relative fair value for the liability components and for the equity components. The Company concluded that the liability component includes beneficial conversion features. Under ASC 470-20-25, issuers of certain debt instruments with beneficial conversion features need to allocate to an equity component an amount based on the amount that the feature is in-the-money at the commitment date, which the Company did.

Pursuant to the Third Amendment and the Warrants Amendment, the Company considered the restructured short-term debt to D4 Holdings under the criteria of, and accounted for the restructured short-term debt as, a troubled debt restructuring in accordance with ASC Subtopic 470-60, “Debt-Troubled Debt Restructurings by Debtors”, which requires that the gross future cash flows of principal and interest be reflected in the balance sheet.

The interest expenses relating to both the contractual interest coupon and amortization of the discount on the liability component are as follows:

	For the six months ended June 30,	
	2014	**2013**
	($ in thousands)	
Contractual interest coupon	330	272
Amortization of the discount on the liability components	179	80
Total interest expense on short-term loans	509	352

On March 28, 2014, we and our subsidiaries entered into the D4 Forbearance Agreement with D4 Holdings. In connection with the extension of the maturity dates under the Third Amendment, the Company issued to D4 Holdings a warrant, exercisable for ten years, to purchase up to 10,000,000 shares of the Company's common stock at an exercise price of $0.02 per share. We accounted for the Warrants amendment as a modification of debt terms as required under EITF 86-18 “Debtor’s accounting for a Modification of Debt Terms” and with accordance with ASC 470-50-40. As instructed, we established a new effective interest rate based on the carrying value of the debt and the revised cash flows under the new terms of debt.

The table below details the book value of short-term loan and the amortization balance of the discount on the liability’s component:

	As of	
	June 30, 2014	**December 31, 2013**
	($ in thousands)	
Book value of short-term loan prior to modification	5,469	4,960
Change in fair value related to the benefit feature	(498)	-
Net balance of modified short-term loan	4,971	4,960

Item 2. **Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Management's Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains 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 forward-looking statements are based on current expectations, estimates, forecasts and projections about us, our future performance, the industries in which we operate our beliefs and our management's assumptions. In addition, other written or oral statements that constitute forward-looking statements may be made by us or on our behalf. Words such as "may," "expect," "anticipate," "forecast," "intend," "plan," "believe," "seek," "estimate," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to assess. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. These risks and uncertainties include, but are not limited to, the following:

- our ability to obtain additional capital in the immediate term to finance operations;
- our ability to meet our obligations under outstanding indebtedness, and the impact of any remedies our secured lender and other counterparties may seek thereunder;
- our ability to successfully pursue strategic alternatives in the event we are unable to increase revenues and generate additional cash;
- our ability to increase revenues and generate additional cash;
- our dependence on a small number of key customers for a significant percentage of our revenue;
- our ability to retain key personnel and employees needed to support our services and ongoing operations and our ability to continue to effectively maintain our ongoing operations, especially following the reduction in force that we recently effected;
- our ability to operate in international markets, including our ability to receive payments from customers located in such markets;
- decreasing rates of all related telecommunications services;
- the public's acceptance of Video over Internet Protocol, and the level and rate of customer acceptance of our new products and services;
- the competitive environment of VoIP telephony and our ability to compete effectively;
- fluctuations in our quarterly financial results;
- our ability to maintain and operate our computer and communications systems without interruptions or security breaches;
- our ability to provide quality and reliable service, which is in part dependent upon the proper functioning of equipment owned and operated by third parties;
- the uncertainty of future governmental regulation;
- the outcome of our discussions with the New York City Department of Finance regarding the outstanding commercial rent tax, interest and penalties it claims we owe;
- the impact of continuing unrest in the Middle East on our customers doing business in that region;
- our ability to protect our intellectual property against infringement by others, and the costs and diversion of resources relating to any claims that we infringe the intellectual property rights of third parties;
- our ability to comply with governmental regulations applicable to our business;
- the need for ongoing product and service development in an environment of rapid technological change; and
- other risks referenced from time to time in our filings with the SEC.

For a more complete list and description of such risks and uncertainties, as well as other risks, please refer to the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on March 31, 2014. Except as required under the federal securities laws and the rules and regulations promulgated thereunder, we do not have any intention or obligation to update publicly any forward-looking statements or risk factors after the filing of this report, whether as a result of new information, future events, changes in assumptions or otherwise.

Overview

We are a global provider of integrated video and voice over Internet Protocol, or VoIP, telephony services, products, hosted solutions and infrastructure. We were founded in 1996 to capitalize on the growth of the Internet as a communications tool by commercially offering Internet Protocol, or IP, telephony services, or VoIP telephony. VoIP telephony is the real-time transmission of voice communications in the form of digitized "packets" of information over the Internet or a private network, similar to the way in which e-mail and other data is transmitted. While we began as primarily a low-cost alternative source of wholesale minutes for carriers around the world, we have evolved into an international provider of next generation communication services.

Today we support tens of thousands of active users around the globe through our service provider and reseller channel and our direct-to-consumer channel. We have built a privately-managed, state-of-the-art global telecommunications platform using IP technology and we offer a broad suite of private label VoIP products and services as well as a back-office platform. Our operations management tools include, among others: account provisioning; e-commerce-based payment processing systems; billing and account management; operations management; web development; network management; and customer care. Based on our customizable VoIP solutions, these customers can offer private label video and voice-over-IP services to their own customer bases under their own brand name, a “white-label” brand (in which no brand name is indicated and different customers can offer the same product), or the deltathree brand. At the same time, our direct-to-consumer channel includes our joip Mobile application (which is a cellular phone application providing low cost mobile calls over 3G cellular networks as well as WiFi networks) and our iConnectHere offering (which provides VoIP products and services directly to consumers and small businesses online using the same primary platform). We are able to provide our services at a cost per user that is generally lower than that charged by traditional service providers because we minimize our network costs by using efficient packet-switched technology and interconnecting to a wide variety of termination options, which allows us to benefit from pricing differences between vendors to the same termination points.

Prior to 1999, we focused on building a privately-managed, global network utilizing IP technology, and our business primarily consisted of carrying and transmitting traffic for communications carriers over our network. Beginning in 1999, we began to diversify our offerings by layering enhanced IP telephony services over our network. These enhanced services were targeted at consumers and were primarily accessible through our consumer website. During 2000, we began offering services on a co-branded or private-label basis to service providers and other businesses to assist them in diversifying their product offerings to their customer bases. In 2001, we continued to enhance our unique strengths through our pioneering work with the Session Initiation Protocol, or SIP, an Internet Engineering Task Force standard that has been embraced by industry leaders such as Microsoft and Cisco. These efforts culminated in the launch of our state-of-the-art SIP infrastructure, and in doing so we became the first major VoIP service provider to deploy an end-to-end SIP network and services. In recent years, we have continued our pioneering efforts in SIP and these efforts have yielded significant new releases.

In 2009 we began the process of expanding the suite of our communications offerings into the global video phone services market. In the third quarter of 2009 we entered into an agreement with ACN Pacific Pty Ltd., a wholly-owned subsidiary of ACN, Inc., or ACN, pursuant to which we provide digital video and voice-over-IP services in Australia and New Zealand to ACN Pacific. In December 2010 we entered into an agreement with ACN Korea, a wholly-owned subsidiary of ACN, pursuant to which we provide digital video and voice-over-IP services in Korea.

In 2010 we continued to update our network by adding a video mail feature to our video phone applications and launching our joip mobile application in July 2010. Following the launch of the mobile application, in October 2010 we entered into a sales agency agreement with ACN pursuant to which ACN sells a private label version of joip Mobile under the ACN Mobile World brand in the United States and Canada. In addition, we offer the joip Mobile application on a white-label basis to other customers. Finally, we entered into affiliate agreements with different third parties pursuant to which such third parties refer potential subscribers to our joip Mobile application.

In April 2011 we entered into an introducer agreement with ACN Europe B.V., a wholly-owned subsidiary of ACN, pursuant to which ACN Europe refers potential customers in different countries in Europe to a private label version of joip Mobile sold under the ACN Mobile World brand. In November 2011 we entered into a service agreement with Momentis U.S. Corp., a multi-level marketing company, pursuant to which Momentis refers potential customers in North America to a co-branded offering of joip Mobile and other consumer VoIP products and services.

On April 3, 2012, we entered into an amendment to our sales agency agreement with ACN and our introducer agreement with ACN Europe. Pursuant to the terms of the amendment, we are required to pay all then-current commissions on a timely basis as required under the agreements and a late fee in the amount of one percent per month of any past-due, unpaid commissions (which, as of June 30, 2014, was equal to approximately $1,418,000). In addition, beginning July 15, 2012, we were required to pay down any unpaid past due amounts in an amount equal to at least $15,000 per month through June 15, 2013, and at least $25,000 per month thereafter until such time as the unpaid balance is paid in full, and are required to pay in full any unpaid, past due amounts upon 30 days' notice. In addition, in the event of certain insolvency-related events defined in the agreements, all unpaid amounts will become immediately due and payable effective immediately prior to such event.

In July 2012 we began making the $15,000 monthly payment of unpaid commissions, however due to our financial condition we suspended making the monthly payments of the unpaid commissions and the current commissions in April 2013 with the oral consent of ACN and ACN Europe. As discussed below in " – Liquidity and Capital Resources", on June 12, 2014, ACN, ACN Europe and we entered into the ACN Forbearance Agreement.

As a complement to the initiatives we have taken to attempt to organically expand our businesses, we have also evaluated opportunities for growth through strategic relationships. In February 2009 we consummated a transaction with D4 Holdings pursuant to which we sold to D4 Holdings an aggregate of 39,000,000 shares of our common stock and a warrant to purchase up to an additional 30,000,000 shares of our common stock. D4 Holdings is a private investment fund whose ownership includes owners of ACN, a direct seller of telecommunications services. As a result of the transactions with D4 Holdings, we expect to continue to seek opportunities to provide services to ACN and enter into other commercial transactions that give us access to ACN's international marketing and distribution capabilities.

From an operational standpoint, in 2012 we continued to focus our near-term strategy and market initiatives on growing our service provider and digital next generation communications offerings while still supporting our core VoIP reseller and direct-to-consumer business segments.

Going forward, we expect to:

- actively market our products and services to those entities that wish to offer white-label digital next generation communications offerings;
- pursue a targeted strategy of identifying and evaluating appropriate strategic collaborations, such as potentially engaging in commercial transactions with ACN, that we hope will continue to expand and diversify our customer base;
- market and sell our direct-to-consumer products and services through affiliates and our affiliate program; and
- support and maintain our current reseller base, as we expect our revenue from this key channel will continue to represent a significant percentage of our total revenue in the foreseeable future.

As of June 30, 2014, we had negative working capital equal to approximately $7.7 million as well as negative stockholders' equity equal to approximately $7.7 million. We believe it is probable that we will continue to experience losses and increased negative working capital and negative stockholders' equity in the near future and will not be able to return to positive cash flow before we require additional cash in the immediate term. We may experience difficulties accessing the equity and debt markets and raising additional capital, and there can be no assurance that we will be able to raise such additional capital on favorable terms or at all. If additional funds are raised through the issuance of equity securities, our existing stockholders will experience significant further dilution. Because of our significant losses to date and our limited tangible assets, we do not fit traditional credit lending criteria, which could make it difficult for us to obtain loans or to access the capital markets. If we issue additional equity or convertible debt securities to raise funds, the ownership percentage of our existing stockholders would be reduced and they may experience significant dilution. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock.

We believe that, unless we are able to increase revenues and generate additional cash, our current cash and cash equivalents will not satisfy our current projected cash requirements beyond the immediate future. As a result, there is substantial doubt about our ability to continue as a going concern.

In addition, unless we are able to increase revenues and generate additional cash, based on currently projected cash flows we believe that we will be unable to pay future scheduled interest and/or principal payments under the various loan agreements with D4 Holdings as these obligations become due, and beginning January 2013 we suspended making scheduled interest payments. On January 2, 2014, we did not repay to D4 Holdings the outstanding principal and interest due under the First Loan Agreement, which constituted an event of default thereunder and a cross-default under all our other loan agreements with D4 Holdings, following which we and our subsidiaries entered into the Forbearance Agreement with D4 Holdings, or the "D4 Holdings Forbearance Agreement". In the event we are unable to resume making interest payments and to pay the outstanding principal when due following the termination of the D4 Holdings Forbearance Agreement, if D4 Holdings is not willing to waive compliance or otherwise modify our obligations such that we are able to avoid defaulting on such obligations, because D4 Holdings has a lien on all of our assets to secure our obligations under the loan agreements it could take actions under the loan agreements and seek to take possession of or sell our assets to satisfy our obligations thereunder. Any of these actions would likely have an immediate material adverse effect on our business, financial condition or results of operations.

Due to our ongoing losses and reduction in cash, we initiated restructuring activities beginning in the second quarter of 2011 in an effort to cut operating costs significantly and better align our operations with our current business model. In accordance with the restructuring, we instituted a reduction in force and decreased the number of full time employees from approximately 53 to 32, reduced the salaries of all remaining employees by five percent, and decreased non-material expenses as well as payments to be made to vendors and other third parties. In addition, in December 2013 we instituted an additional, smaller reduction in force. As of June 30, 2014, we had 13 full time employees. During March 2014, as an incentive for our remaining employees we reversed the five-percent reduction in salaries that we instituted in 2011.

In view of our current cash resources, nondiscretionary expenses, debt and near term debt service obligations, we have begun exploring strategic alternatives available to us and may explore all such alternatives available to us, including, but not limited to, a sale or merger of our company, a sale of our assets, recapitalization, partnership, debt or equity financing, voluntary deregistration of its securities, financial reorganization, liquidation and/or ceasing operations. In the event that we are unable to secure additional funding, we may determine that it is in our best interests to voluntarily seek relief under Chapter 11 of the U.S. Bankruptcy Code. Seeking relief under the U.S. Bankruptcy Code, even if we are able to emerge quickly from Chapter 11 protection, could have a material adverse effect on the relationships between us and our existing and potential customers, employees, and others. Further, if we were unable to implement a successful plan of reorganization, we might be forced to liquidate under Chapter 7 of the U.S. Bankruptcy Code. There can be no assurance that exploration of strategic alternatives will result in our company pursuing any particular transaction or, if we pursue any such transaction, that it will be completed.

Trends in Our Industry and Business

A number of factors in our industry and business have a significant effect on our results of operations and are important to an understanding of our financial statements. These trends include:

Overall Economic Factors: Our operations and earnings are affected by local, regional and global events or conditions that affect supply and demand for telecommunications products and services. These events or conditions are generally not predictable and include, among other things, general economic growth rates and the occurrence of economic recessions; changes in demographics, including population growth rates; and consumer preferences. Our strategy and execution focus is predicated on an assumption that these factors will continue to promote strong desire for the utilization of telephony products and services and that the cost and feature advantages of VoIP alternatives will not be negatively impacted by unforeseen changes in these factors.

Industry: The telecommunications industry is highly competitive. In recent years we have seen new sources of supply for our underlying infrastructure that have reduced our overall costs of operation, including both advances in telecommunications technology and advances in technology relating to telecommunications usage, and have enjoyed the benefits of competition among these suppliers for a relatively limited amount of viable customers. A key component of our competitive position, particularly given the number and range of competing communications products, is our ability to manage operating expenses successfully, which requires continuous management focus on reducing unit costs and improving efficiency.

Consumer Demand: There is significant competition within the traditional telecommunications marketplaces (landline and wireless) and also with other emerging next generation telecommunications providers, including IP telecommunications providers, in supplying the overall telecommunications needs of businesses and individual consumers.

A key component of our competitive position, particularly given the commodity-based nature of many of our products, is our ability to sell to a growing demand base for alternative communications products, in both the developed and developing global marketplace. Within the developed global marketplace, our ability to sell broadband video and voice-over-IP products and services is directly linked to the significant growth rate of broadband adoption, and we expect this trend to continue. We benefit from this trend because our service requires a broadband Internet connection and our potential addressable market increases as broadband adoption increases. Within the developing areas of the world, our ability to sell alternative telephony products and services is linked to both the increasing baseline economic trends within these countries as well as the growing desire for individuals and businesses to communicate and do business outside of their own countries. We expect these trends to continue, and benefit from them because both the ability to afford long distance calls and the desire to make them increase as a result.

Political Factors: Our operations and earnings have been, and may in the future be, affected from time to time in varying degree by political instability, social unrest (including the recent and continuing social unrest in the Middle East) and by other political developments and laws and regulations, such as: telecommunications regulations; war, civil war, armed conflict, terrorism and other international conflicts; restrictions on production, imports and exports; price controls; tax increases and retroactive tax claims; expropriation of property; and cancellation of contract rights. Both the likelihood of such occurrences and their overall effect upon us vary greatly from country to country and are not predictable. At the same time, VoIP is becoming legal in more countries as governments seek to increase competition, and this helps us as service providers and resellers seek to meet their customers' telecommunications needs with newly available solutions. Both the likelihood of VoIP legalization and its overall effect upon us vary greatly from country to country and are not predictable.

Regulatory Factors: Our business has developed in an environment largely free from regulation. However, the United States and other countries have begun to examine how VoIP services should be regulated and to begin instituting such regulation, and a number of initiatives could have an impact on our business. These initiatives include the assertion of state regulatory and taxing authorities over us, FCC rulemaking regarding emergency calling services, the imposition of law-enforcement obligations like the Communications Assistance for Law Enforcement Act, referred to as "CALEA", marketing restrictions and data protection rules for Customer Proprietary Network Information, referred to as "CPNI", access to relay services for people with disabilities, local number portability, proposed reforms for the inter-carrier compensation system, and an ongoing generic rulemaking considering the classification of interconnected VoIP services under federal law. Complying with regulatory developments will impact our business by increasing our operating expenses, including legal fees, requiring us to make significant capital expenditures or increasing the taxes and regulatory fees we pay. We may impose additional fees on our customers in response to these increased expenses. This would have the effect of increasing our revenues per customer, but not our profitability, and increasing the cost of our services to our customers, which would have the effect of decreasing any price advantage we may have over traditional telecommunications companies.

Project Factors: In addition to the factors cited above, the advancement, cost and results of particular projects depend on the outcome of: negotiations with potential partners, governments, suppliers, customers or others; changes in operating conditions or costs; and the occurrence of unforeseen technical difficulties or enhancements. The likelihood of these items occurring and its overall positive or negative effect upon us vary greatly from project to project and are not predictable.

Risk Factors: For a discussion of the impact of market risks, financial risks and other risks and uncertainties that we face, see “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on March 31, 2014.

Revenues

Our revenues are derived mainly from resellers, service providers, and direct consumers of our video and voice-over-IP products and services. Revenue is recognized from these products and services as follows:

- postpaid minutes: revenue from the sale of minutes on a postpaid basis (primarily sold to our wholesale resellers) is recognized at the time such minutes are used;
- prepaid minutes: prepayments for communications services and the sale of minutes are deferred and recognized as revenue at the time communications services are provided and at the time the minutes are utilized , service charges are levied or remaining balances expire. We conduct evaluations of outstanding prepaid balances that do not have expiration dates or service fees associated with them to determine, based on terms and condition of agreements and historical data, whether such balances are likely to be utilized. If we determine that balances are unlikely to be used, the deferred revenue liability is reduced accordingly and other revenue is recognized. The outstanding prepaid balances likely to be utilized are reconciled to our deferred revenue account and deferred revenue is increased or decreased accordingly to properly reflect our estimated liability;
- monthly recurring charges: revenue from fees such as set monthly recurring charges based on the level of service or calling plans that the subscriber subscribes for is recognized as the applicable service is provided; and
- other revenues: these revenues include, but are not limited to, prepaid balances with no services fees or expiration dates that are unlikely to be utilized.

The following sets forth our revenues per segment for the six months ended June 30, 2014 and 2013:

	Three Months Ended June 30,		Six Months Ended June 30,	
Segment	**2014**	**2013**	**2014**	**2013**
	($ in thousands)		**($ in thousands)**	
Reseller	$ 3,784	$ 3,349	$ 7,452	$ 6,040
Direct-to-consumer	268	539	584	1,201
Service provider	303	261	598	532
Other	36	67	76	173
Total	$ 4,391	$ 4,216	$ 8,710	$ 7,946

The provision of video and voice-over-IP products and services through our reseller, direct-to-consumer and service provider channels accounted for approximately 86.2% and 79.4%, 6.1% and 12.8%, and 6.9% and 6.2%, respectively, of our total revenues for the three months ended June 30, 2014 and 2013.

Costs and Operating Expenses

Costs and operating expenses consist of the following: cost of revenues; research and development expenses; selling and marketing expenses; general and administrative expenses; and depreciation and amortization.

Cost of revenues consist primarily of network, access, termination and transmission costs paid to carriers that we incur when providing services and fixed costs associated with leased transmission lines. The term of our contracts for leased transmission lines is generally one year or less, and either party can terminate with prior notice.

Research and development expenses consist primarily of costs associated with establishing our network and the initial testing of our services and compensation expenses of software developers involved in new product development and software maintenance. Since our inception, we have expensed all research and development costs in each of the periods in which they were incurred.

Selling and marketing expenses consist primarily of expenses associated with our direct sales force incurred to attract potential service provider, reseller, and customers. In addition, we expense all sales commissions paid to third parties that sell our products and services pursuant to the terms of our agreements with such third parties.

General and administrative expenses consist primarily of compensation and benefits for management, finance and administrative personnel, insurance premiums, occupancy costs, legal and accounting fees and other professional fees. Additionally, we incur expenses associated with our being a public company, including the costs of directors' and officers' insurance.

Depreciation and amortization consists of the depreciation calculated on our fixed assets.

We have not recorded any income tax benefit for net losses and credits incurred for any period from inception to June 30, 2014. The utilization of these losses and credits depends on our ability to generate taxable income in the future. Because of the uncertainty of our generating taxable income going forward, we have recorded a full valuation allowance with respect to these deferred assets.

Net Operating Losses

As of June 30, 2014, we had net operating losses, or NOLs, generated in the U.S. of approximately $23.6 million and Delta Three Israel Ltd., our wholly-owned subsidiary, had NOLs of approximately $4.5 million. Our issuance of common stock to D4 Holdings in February 2009 constituted an "ownership change" as defined in Section 382 of the Internal Revenue Code. As a result, under Section 382 our ability to utilize NOLs generated in the U.S. prior to February 2009 (equal to approximately $156 million) to offset any income we may generate in the future will be limited to approximately $600,000 per year from February 2009. The NOLs began to expire in 2011 and will continue to expire at various dates until 2029 if not utilized. Our ability to utilize our remaining NOLs could be additionally reduced if we experience any further "ownership change," as defined under Section 382.

Results of Operations - Three Months Ended June 30, 2014, Compared to Three Months Ended June 30, 2013

Revenues

Revenues increased by approximately $0.2 million, or 5%, to approximately $4.4 million for the three months ended June 30, 2014, from approximately $4.2 million for the three months ended June 30, 2013. During this period the number of minutes carried by our network slightly increased by approximately 1% from approximately 74.1 million minutes during the three months ended June 30, 2013, to approximately 74.5 million minutes for the corresponding period in 2014. This was caused, in large part, by a decrease of approximately 6 million minutes utilized by our third-largest reseller during the three months ended June 30, 2014, compared to the number of minutes utilized by such reseller during the corresponding period in 2013. This decrease was partially offset by an increase of 1.6 million minutes utilized by our largest reseller, for which we terminated a large number of calls to higher-rate destinations during this period, as well as an increase of approximately 8.5 million minutes generated by other resellers. In addition, although we experienced an increase in the revenues generated by our reseller division, the overall gross margin decreased due to a decrease in revenue in our direct-to-consumer division, as the gross margins from such division are significantly higher than the gross margins generated by our reseller division. The number of minutes utilized by our direct-to-consumer division decreased by approximately 4.1 million minutes during the three months ended June 30, 2014, compared to the number of minutes utilized by this division during the corresponding period in 2013.

Revenues generated by our reseller division increased by approximately $0.5 million, or 15%, to approximately $3.8 million for the three months ended June 30, 2014, from approximately $3.3 million for the three months ended June 30, 2013. Our two largest resellers accounted for approximately $3.2 million, or approximately 85%, of the revenue generated from our reseller division for the three months ended June 30, 2014, which represented approximately 73% of our total revenue for such period. By comparison, for the three months ended June 30, 2013, our two largest resellers accounted for approximately 92% of the revenue generated from our reseller division, or approximately 73% of our total revenue during such period.

Revenues generated by our service provider division increased by approximately $42,000, or 16%, from approximately $261,000 for the three months ended June 30, 2013, to approximately $303,000 for the three months ended June 30, 2014. This increase was primarily due to an increase in revenues generated by one of our affiliates.

Sales to direct consumers decreased by approximately $270,000 or 50%, to approximately $268,000 for the three months ended June 30, 2014, from approximately $538,000 for the three months ended June 30, 2013. Revenues generated through our iConnectHere offering declined by approximately $27,000 from approximately $112,000 for the three months ended June 30, 2013, to approximately $85,000 for the three months ended June 30, 2014. In addition, the revenues generated by our joip Mobile offering decreased from $390,000 for the three months ended June 30, 2013, to approximately $162,000 for the three months ended March 31, 2014.

Costs and Operating Expenses

Cost of revenues. Cost of revenues increased by approximately $0.3 million, or 9%, from approximately $3.4 million for the three months ended June 30, 2013, to approximately $3.7 million for the three months ended June 30, 2014. Our network rent cost decreased by approximately $47,000 from approximately $254,000 for the three months ended June 30, 2013, to approximately $207,000 for the three months ended June 30, 2014. Our termination cost increased by approximately $0.4 million, or 13%, from approximately $3.0 million for the three months ended June 30, 2013, to approximately $3.4 million for the three months ended June 30, 2014. The increase in termination cost was primarily caused by our largest reseller, which generated approximately $2.7 million of termination costs for the three months ended June 30, 2014, partially offset by a decline in the termination costs of our third-largest reseller of approximately $100,000 during this period. In addition, during this period our largest reseller utilized minutes through our network that were more expensive for us than the minutes that were utilized by our third-largest reseller.

Research and development expenses. Research and development expenses decreased by approximately $60,000, or 20%, from approximately $295,000 for the three months ended June 30, 2013, to approximately $235,000 for the three months ended June 30, 2014. As a percentage of revenues, research and development expenses for the three months ended June 30, 2014, was approximately 5% compared to approximately 7% for the three months ended June 30, 2013.

Selling and marketing expenses. Selling and marketing expenses decreased by approximately $144,000 or 45%, to approximately $175,000 for the three months ended June 30, 2014, from approximately $319,000 for the three months ended June 30, 2013. The main reason for the decrease was a decline in commissions we were required to pay ACN, ACN Europe and Momentis pursuant to our respective agreements with them. As a percentage of revenues, selling and marketing expenses decreased to approximately 4% for the three months ended June 30, 2014, from approximately 8% for the three months ended June 30, 2013.

General and administrative expenses. General and administrative expenses remained flat at approximately $350,000 for the three months ended June 30, 2014 and 2013.. As a percentage of revenues, general and administrative expenses for the three months ended June 30, 2014 and 2013 was approximately 8%. During the three months ended June 30, 2014 we recorded a provision for the complaint filed against us, ACN, and ACN Communication Services by Telinit Technology LLC claiming infringement of a patent claimed to be owned by Telinit, as discussed below in Part II, Item 1. "Legal Proceedings".

Depreciation and amortization. Depreciation and amortization decreased by approximately $12,000, or 32%, from approximately $37,000 for the three months ended June 30, 2013, to approximately $25,000 for the three months ended June 30, 2014.

Loss from Operations

For the three months ended June 30, 2014, we recorded a loss from operations of approximately $53,000 compared to a loss from operations of approximately $210,000 for the three months ended June 30, 2013, due to the factors set forth above.

Interest Expense, Net

We recorded interest expense of approximately $379,000 for the three months ended June 30, 2014, compared to approximately $198,000 for the three months ended June 30, 2013. Interest expense consisted of interest recorded under our loan agreements with D4 Holdings of approximately $168,000, and $130,000 which we recorded as the aggregate amount for both the warrant we issued to D4 Holdings in connection with the Second Loan Agreement and the warrant and Convertible Note we issued to D4 Holdings in connection with the Third Loan Agreement.

Income Taxes, Net

We recorded net income tax expenses of $5,000 for the three months ended June 30, 2014.

Net Loss

For the three months ended June 30, 2014, we recorded a net loss of approximately $466,000 compared to a net loss of approximately $414,000 for the three months ended June 30, 2013, due to the factors set forth above.

Results of Operations - Six Months Ended June 30, 2014, Compared to Six Months Ended June 30, 2013

Revenues

Revenues increased by approximately $0.7 million, or 9%, to approximately $8.7 million for the six months ended June 30, 2014, from approximately $7.9 million for the six months ended June 30, 2013. During this period the number of minutes carried by our network decreased by approximately 8% from approximately 153 million minutes during the six months ended June 30, 2013, to approximately 148 million minutes for the corresponding period in 2014. This was caused, in large part, by a decrease of approximately 16 million minutes utilized by our third-largest reseller during the six months ended June 30, 2014, compared to the number of minutes utilized by such reseller during the corresponding period in 2013. This decrease was partially offset by an increase of 6 million minutes utilized by our largest reseller, for which we terminated a large number of calls to higher-rate destinations during this period. In addition, although we experienced an increase in the revenues generated by our reseller division, the overall gross margin decreased due to a decrease in revenue in our direct-to-consumer division, as the gross margins from such division are significantly higher than the gross margins generated by our reseller division. The number of minutes utilized by our direct-to-consumer division decreased by approximately 8.2 million minutes during the six months ended June 30, 2014, compared to the number of minutes utilized by this division during the corresponding period in 2013

Revenues generated by our reseller division increased by approximately $1.4 million, or 23%, to approximately $7.4 million for the six months ended June 30, 2014, from approximately $6.0 million for the six months ended June 30, 2013. Our two largest resellers accounted for approximately $6.5 million, or approximately 87%, of the revenue generated from our reseller division for the six months ended June 30, 2014, which represented approximately 74% of our total revenue for such period. By comparison, for the six months ended June 30, 2013, our two largest resellers accounted for approximately 92% of the revenue generated from our reseller division, or approximately 70% of our total revenue during such period.

Revenues generated by our service provider division increased by approximately $65,000, or 12%, from approximately $532,000 for the six months ended June 30, 2013, to approximately $597,000 for the six months ended June 30, 2014. This increase was primarily due to an increase of revenues generated by one of our affiliates.

Sales to direct consumers decreased by approximately $617,000, or 52%, to approximately $316,000 for the six months ended June 30, 2014, from approximately $1.2 million for the six months ended June 30, 2013. Revenues generated through our iConnectHere offering declined by approximately $52,000 from approximately $231,000 for the six months ended June 30, 2013, to approximately $179,000 for the six months ended June 30, 2014. In addition, the revenues generated by our joip Mobile offering decreased from $900,000 for the six months ended June 30, 2013, to approximately $360,000 for the six months ended June 30, 2014.

Costs and Operating Expenses

Cost of revenues. Cost of revenues increased by approximately $1.0 million, or 16%, from approximately $6.2 million for the six months ended June 30, 2013, to approximately $7.2 million for the six months ended June 30, 2014. Our network rent cost decreased by approximately $100,000 from approximately $520,000 for the six months ended June 30, 2013, to approximately $420,000 for the six months ended June 30, 2014. Our termination cost increased by approximately $1.1 million, or 20%, from approximately $5.5 million for the six months ended June 30, 2013, to approximately $6.6 million for the six months ended June 30, 2014. The increase in termination cost was primarily caused by our largest reseller, which generated approximately $5.3 million of termination costs for the six months ended June 30, 2014, partially offset by a decline in the termination costs of our third-largest reseller of approximately $215,000 during this period. In addition, during this period our largest reseller utilized minutes through our network that were more expensive for us than the minutes that were utilized by our second-largest reseller.

Research and development expenses. Research and development expenses decreased by approximately $78,000, or 13%, from approximately $588,000 for the six months ended June 30, 2013, to approximately $510,000 for the six months ended June 30, 2014. As a percentage of revenues, research and development expenses for the six months ended June 30, 2014, was approximately 6% compared to approximately 7% for the six months ended June 30, 2013.

Selling and marketing expenses. Selling and marketing expenses decreased by approximately $313,000, or 44%, to approximately $399,000 for the six months ended June 30, 2014, from approximately $712,000 for the six months ended June 30, 2013. The main reason for the decrease was a decline in commissions we were required to ACN, ACN Europe and Momentis pursuant to our respective agreements with them. As a percentage of revenues, selling and marketing expenses decreased to approximately 5% for the six months ended June 30, 2014, from approximately 9% for the six months ended June 30, 2013.

General and administrative expenses. General and administrative expenses decreased slightly by approximately $21,000, or 4%, to approximately $680,000 for the six months ended June 30, 2014, from approximately $701,000 for the six months ended June 30, 2013. As a percentage of revenues, general and administrative expenses for the six months ended June 30, 2014 was approximately 8% compared to approximately 8% for the six months ended June 30, 2013. During the six months ended June 30, 2014 we recorded a provision for the complaint filed against us filed against us, ACN, and ACN Communication Services by Telinit Technology LLC claiming infringement of a patent claimed to be owned by Telinit, as discussed below in Part II, Item 1. "Legal Proceedings".

Depreciation and amortization. Depreciation and amortization decreased by approximately $26,000, or 34%, from approximately $76,000 for the six months ended June 30, 2013, to approximately $50,000 for the six months ended June 30, 2014.

Loss from Operations

For the six months ended June 30, 2014, we recorded a loss from operations of approximately $136,000 compared to a loss from operations of approximately $348,000 for the six months ended June 30, 2013, due to the factors set forth above.

Interest Expense, Net

We recorded interest expense of approximately $621,000 for the six months ended June 30, 2014, compared to approximately $405,000 for the six months ended June 30, 2013. Interest expense consisted of interest recorded under our loan agreements with D4 Holdings of approximately $330,000, and $179,000 which we recorded as the aggregate amount for both the warrant we issued to D4 Holdings in connection with the Second Loan Agreement and the warrant and Convertible Note we issued to D4 Holdings in connection with the Third Loan Agreement.

Income Taxes, Net

We recorded net income tax expenses of $11,000 for the six months ended June 30, 2014.

Net Loss

For the six months ended June 30, 2014, we recorded a net loss of approximately $797,000 compared to a net loss of approximately $770,000 for the six months ended June 30, 2013, due to the factors set forth above.

Liquidity and Capital Resources

Since our inception in June 1996, we have incurred significant operating and net losses due in large part to the start-up and development of our operations and our losses from operations. For the six months ended June 30, 2014, we recorded net loss from operations of approximately $165,000 compared to a net loss from operations of approximately $348,000 for the six months ended June 30, 2013. To date, we have an accumulated deficit of approximately $185.6 million.

As of June 30, 2014, we had cash and cash equivalents of approximately $154,000 and restricted cash and short-term investments of approximately $4,000, or a total of cash, cash equivalents and restricted cash of $158,000, a decrease of approximately $34,000 from December 31, 2013. The decrease in cash and cash equivalents including the restricted cash and short-term investments was primarily caused by net cash used in operating activities of approximately $24,000 during the six months ended June 30, 2014, and by net cash provided by investing activity of approximately $19,000 during the six months ended June 30, 2014.

Cash used in or provided by operating activities is net loss adjusted for certain non-cash items and changes in assets and liabilities. We had negative cash flow from operating activities of approximately $24,000 during the six months ended June 30, 2014 and negative cash flow from operating activities of approximately $110,000 during the six months ended June 30, 2013. The increase in our cash generated from operating activities was primarily due to accumulated interest on short-term loan of $330,000 and an increase in accounts receivable of $216,000, offset by an increase in accounts payable of $395,000.

Net cash used in or provided by investing activities is generally driven by our capital expenditures and changes in our short and long-term investments. For the six months ended June 30, 2014, we received $30,000 of previously restricted cash.

Net cash used in or provided by financing activities is generally driven by drawing down amounts available under lines of credit available to us, issuing shares of our capital stock and receiving cash that we had previously pledged or otherwise deposited as security for our lenders and creditors. For the six months ended June 30, 2014 and 2013, we did not draw down any amounts under our loan agreements with D4 Holdings.

Financing cash flows have historically consisted primarily of payments of capital leases and proceeds from the exercise of options we have granted to our employees and directors. In February 2009 we consummated a transaction with D4 Holdings pursuant to which we sold to D4 Holdings an aggregate of 39,000,000 shares of our common stock and a warrant to purchase up to an additional 30,000,000 shares of our common stock for an aggregate purchase price of $1,200,000. In addition, on March 1, 2010, we and our subsidiaries entered into the First Loan Agreement with D4 Holdings pursuant to which D4 Holdings agreed to provide us and our subsidiaries a line of credit in a principal amount of $1,200,000. On August 10, 2010, we and our subsidiaries entered into the Second Loan Agreement with D4 Holdings, pursuant to which D4 Holdings agreed to provide us and subsidiaries an additional line of credit in a principal amount of $1,000,000. In connection with the Second Loan Agreement, we issued to D4 Holdings a warrant to purchase up to 4,000,000 shares of our common stock at an exercise price of $0.1312 per share. We have drawn down all amounts available to be borrowed under the two lines of credit.

On March 2, 2011, we and our subsidiaries entered into the Third Loan Agreement with D4 Holdings, pursuant to which D4 Holdings agreed to provide us and its subsidiaries an additional line of credit in a principal amount of $1,600,000. Pursuant to the terms of the Convertible Note issued by us in connection with the Third Loan Agreement, D4 Holdings may elect to convert all or any portion of the outstanding principal amount under the Convertible Note into that number of shares of our common stock determined by dividing such principal amount by $0.08 (as may be adjusted under the terms of the Convertible Note). Simultaneous with our entering into the Third Loan Agreement, D4 Holdings and we entered into an amendment of the First Loan Agreement, pursuant to which (among other things) the maturity date for repayment of principal under the First Loan Agreement was extended from March 1, 2011, to March 1, 2012, and then subsequently extended by oral agreement of the parties to July 1, 2012, and then subsequently orally extended again to January 2, 2014, pending the parties' finalizing and entering into a formal amendment. In connection with the Third Loan Agreement, we issued D4 Holdings a warrant to purchase up to 1,000,000 shares of our common stock at an exercise price of $0.096 per share. We have drawn down the aggregate principal amount available under the Third Loan Agreement, the principal amount of which can be converted by D4 Holdings into an aggregate of 20,000,000 shares of our common stock.

On September 12, 2011, we and our subsidiaries entered into the Fourth Loan Agreement with D4 Holdings, pursuant to which D4 Holdings agreed to provide us and our subsidiaries an additional line of credit in a principal amount of $300,000. We have drawn down all amounts available to be borrowed under the Fourth Loan Agreement.

On November 13, 2012, we and our subsidiaries entered into the Third Amendment to Loan and Security Agreements, or the "Third Amendment", and the Amendment to Warrant Agreements, or the "Warrants Amendment", with D4 Holdings. Pursuant to the Third Amendment and the Warrants Amendment:

- the maturity date for repayment of principal and interest under the First Loan Agreement was extended to January 2, 2014;
- the maturity date for repayment of principal and interest under the Second Loan Agreement was extended to January 2, 2015;
- the maturity date for repayment of principal and interest under each of the Third and Fourth Loan Agreements was extended to January 2, 2016;
- all interest outstanding under each of the loan agreements was added to the principal amount outstanding under the respective loan agreement and the promissory notes issued pursuant to each respective loan agreement was increased by such amount; and
- the exercise price under each of the Warrant Agreements entered into by us and D4 Holdings as of February 12, 2009, August 10, 2010, and March 2, 2011 was amended to $0.02 per share.

In connection with the extension of the maturity dates under the Third Amendment, we issued to D4 Holdings a warrant, exercisable for ten years, to purchase up to 10,000,000 shares of our common stock at an exercise price of $0.02 per share.

During the six months ended June 30, 2014, options to purchase 37,500 shares of our common stock were exercised by our then-current employees and directors. We did not record any expenses for capital leases during the six months ended June 30, 2014.

On January 2, 2014, we did not repay to D4 Holdings the outstanding principal and interest due under the First Loan Agreement, which constituted an event of default thereunder and a cross-default under all our other loan agreements with D4 Holdings. On March 28, 2014, we and our subsidiaries entered into the D4 Holdings Forbearance Agreement with D4 Holdings. Pursuant to the terms and conditions of the D4 Holdings Forbearance Agreement, D4 Holdings agreed to forbear from taking any action with respect to the events of default until the earlier of (i) December 31, 2014, (ii) the occurrence of a breach or default by us or our subsidiaries under the D4 Holdings Forbearance Agreement (which, in the event of certain undertakings of ours under the D4 Holdings Forbearance Agreement, are not cured within three days) or (iii) the occurrence of any new or additional event of default under our loan agreements with D4 Holdings. In addition, to the extent not yet perfected we and our subsidiaries pledged and granted as a security interest to D4 Holdings all of our right, title and interest in the collateral described in the D4 Holdings Forbearance Agreement. In connection with the D4 Holdings Forbearance Agreement we also issued to D4 Holdings a warrant, exercisable for ten years, to purchase up to 10,000,000 shares of our common stock at an exercise price of $0.02 per share.

On July 5, 2011, we received a notice from the New York City Department of Finance that claimed that we had not paid commercial rent tax required under the New York City Administrative Code from June 1998 through May 2008 for the two offices that we had leased during that time. The notice stated that we are obligated to pay the outstanding tax amounts, as well as significant interest and penalties that were assessed on the unpaid amounts as well as for the failure to file the applicable tax returns. We engaged outside counsel, which began discussions with the Department of Finance, and contested the assessment and simultaneously attempted to negotiate a significant reduction in the amounts to be paid. Our appeal was rejected in July 2012 by an examiner in the Department of Finance, and we have subsequently engaged and begun discussions with a manager in the Department of Finance and submitted additional supporting materials. The final outcome of this assessment and our negotiations with the New York City Department of Finance cannot be determined at this time. In the event that we are required to pay all or most of the amounts claimed by the New York City Department of Finance this would have a material adverse effect on our financial condition and liquidity. During 2011 we recorded $300,000 as a provision for commercial rent tax.

We experience fluctuations in our cash cycle, as we generally make payments to our termination suppliers more frequently (often on a weekly basis) than we receive payments from our customers (often on a monthly basis). In the event one of our customers did not pay us, we would experience a direct loss of the amounts we had already paid to our termination suppliers. We maintain our free cash in accounts with major banks located in the United States, and generally do not invest such cash in short or long-term investments. As a way to try to offset our declining cash position we generally seek to extend payment terms to our suppliers other than our termination providers.

We have historically obtained our funding from our utilization of the remaining proceeds from our initial public offering, offset by positive or negative cash flow from our operations, and most recently from the sale of shares of our common stock to D4 Holdings in February 2009 and borrowings under our loan agreements with D4 Holdings. These proceeds are maintained as cash, restricted cash, and short and long term investments. We have sustained significant operating losses in recent periods, which have led to a significant reduction in our cash reserves.

On April 3, 2012, we entered into an amendment to our sales agency agreement with ACN and our introducer agreement with ACN Europe. Pursuant to the terms of the amendment, beginning April 1, 2012, we are required to pay all current commissions on a timely basis as required under the agreements and a late fee in the amount of one percent per month of any past-due, unpaid commissions (which, as of June 30, 2014, was equal to approximately $1,418,000). In addition, beginning July 15, 2012, we are required to pay down any unpaid past due amounts in an amount equal to at least $15,000 per month through June 15, 2013, and at least $25,000 per month thereafter until such time as the unpaid balance is paid in full, and are required to pay in full any unpaid, past due amounts upon 30 days' notice.

In July 2012 we began making the $15,000 monthly payment, however due to our financial condition we suspended making the monthly payments of the unpaid commissions and the current commissions in April 2013 with the oral consent of ACN and ACN Europe. On June 12, 2014, each of us and our wholly-owned subsidiaries Delta Three Israel, Ltd., or "Delta Three Israel", and DME Solutions, Inc., or "DME", and together with us and Delta Three Israel, the "deltathree Entities", and ACN, Inc., or "ACN", ACN Europe B.V., or "ACN Europe", ACN Digital Phone Service, LLC, or "DPS", and together with ACN, Inc. and ACN Europe, the "ACN Entities", entered into the Amended and Restated Agreement Concerning Outstanding/Future Commissions and Security Agreement, or the "ACN Forbearance Agreement". The ACN Forbearance Agreement amends that certain letter amendment, dated as of April 3, 2012, to each of the Sales Agency Agreement dated as of September 27, 2010, and amended as of January 26, 2011, or the "Sales Agency Agreement", between the deltathree Entities and ACN, and the Introducer Agreement, dated as of April 13, 2011, between the deltathree Entities and ACN Europe B.V., or the "Introducer Agreement", in regards to outstanding commissions due to be paid by us to ACN and ACN Europe under those agreements. The ACN Forbearance Agreement also amends that certain License Assignment entered into on February 7, 2013 between us and DPS and the outstanding license assignment payment due to be paid by us to DPS.

The terms of the ACN Forbearance Amendment provide as follows:

- commencing with the date of the ACN Forbearance Agreement, a late fee in the amount of one percent (1%) per month will accrue on any unpaid commissions and the license assignment payment, and commencing on July 15, 2014, and continuing on the 15th day of each month thereafter the deltathree Entities will pay to ACN and ACN Europe the interest that accrued during the previous month;

- in addition, commencing on July 15, 2014, and continuing on the 15th day of each month thereafter, the deltathree Entities will (i) pay down any outstanding obligations, provided that the amount of each monthly payment will be equal to at least $114,000, and (ii) pay all then-current commissions under the Sales Agency Agreement and Introducer Agreement and any cure periods provided for under the respective agreements for non-payment will no longer apply;
- so long as the deltathree Entities fulfill the terms of the ACN Forbearance Agreement, the ACN Entities will forbear from exercising any rights they may have for any breach by the deltathree Entities under the Sales Agency Agreement and the Introducer Agreement and permit us to pay the license assignment payment over time in accordance with the terms and conditions of the ACN Forbearance Agreement until July 31, 2014, or the "Initial Forbearance Period". Upon the expiration of the Initial Forbearance Period, the ACN Entities' obligation to forbear will automatically renew on a monthly basis unless terminated by either party under the terms of the ACN Forbearance Agreement until July 15, 2015, following which such the ACN Entities' obligation to forbear will not automatically renew;
- upon the expiration of the Initial Forbearance Period or any subsequent renewals, unless the ACN Entities' requirement to forbear is renewed, all unpaid obligations will become immediately due and payable;
- each of Delta Three Israel and DME guaranteed the payment and performance of our obligations under the license assignment and under the ACN Forbearance Agreement;
- to secure the payment and performance in full of all of their obligations under the agreement, the deltathree Entities granted to the ACN Entities a continuing security interest in, and pledged to the ACN Entities, all of their right, title and interest in, to and under the collateral set forth on Exhibit A of the ACN Forbearance Agreement; and
- in the event of any Event of Default (as defined in the ACN Forbearance agreement), all unpaid amounts due from the deltathree Entities will become immediately due and payable and the ACN Entities may in their sole discretion terminate the ACN Forbearance Agreement and exercise their rights and pursue all remedies available to them as a secured creditor and at law or in equity.

We did not make the payments we were required to make to the ACN Entities on July 15, 2014, described in the first and second bullet points above, and are currently in default under the ACN Forbearance Agreement.

As of June 30, 2014, we had negative working capital equal to approximately $7.7 million as well as negative stockholders' equity equal to approximately $7.7 million. We believe it is probable that we will continue to experience losses and increased negative working capital and negative stockholders' equity in the near future and will not be able to return to positive cash flow before we require additional cash in the immediate term. We may experience difficulties accessing the equity and debt markets and raising additional capital, and there can be no assurance that we will be able to raise such additional capital on favorable terms or at all. If additional funds are raised through the issuance of equity securities, our existing stockholders will experience significant further dilution. Because of our significant losses to date and our limited tangible assets, we do not fit traditional credit lending criteria, which could make it difficult for us to obtain loans or to access the capital markets. If we issue additional equity or convertible debt securities to raise funds, the ownership percentage of our existing stockholders would be reduced and they may experience significant dilution. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock.

We believe that, unless we are able to increase revenues and generate additional cash, our current cash and cash equivalents will not satisfy our current projected cash requirements beyond the immediate future. As a result, there is substantial doubt about our ability to continue as a going concern.

In addition, unless we are able to increase revenues and generate additional cash, based on currently projected cash flows we believe that we will be unable to pay future scheduled interest and/or principal payments under the various loan agreements with D4 Holdings as these obligations become due, and beginning January 2013 we suspended making scheduled interest payments. On January 2, 2014, we did not repay to D4 Holdings the outstanding principal and interest due under the First Loan Agreement, which constituted an event of default thereunder and a cross-default under all our other loan agreements with D4 Holdings, following which we and our subsidiaries entered into the D4 Holdings Forbearance Agreement. In the event we are unable to resume making interest payments and to pay the outstanding principal when due following the termination of the D4 Holdings Forbearance Agreement, if D4 Holdings is not willing to waive compliance or otherwise modify our obligations such that we are able to avoid defaulting on such obligations, because D4 Holdings has a lien on all of our assets to secure our obligations under the loan agreements it could take actions under the loan agreements and seek to take possession of or sell our assets to satisfy our obligations thereunder. Any of these actions would likely have an immediate material adverse effect on our business, financial condition or results of operations.

Due to our ongoing losses and reduction in cash, we initiated restructuring activities beginning in the second quarter of 2011 in an effort to cut operating costs significantly and better align our operations with our current business model. In accordance with the restructuring, we instituted a reduction in force and decreased the number of five employees from approximately 53 to 32, reduced the salaries of all remaining employees by five percent, and decreased non-material expenses as well as payments to be made to vendors and other third parties. In addition, in December 2013 we instituted an additional, smaller reduction in force. As of June 30, 2014, we had 13 full time employees. During March 2014, as an incentive for our remaining employees we reversed the five-percent reduction in salaries that we instituted in 2011.

In view of our current cash resources, nondiscretionary expenses, debt and near term debt service obligations, we have begun exploring strategic alternatives available to us and may explore all such alternatives available to us, including, but not limited to, a sale or merger of our company, a sale of our assets, recapitalization, partnership, debt or equity financing, voluntary deregistration of its securities, financial reorganization, liquidation and/or ceasing operations. In the event that we are unable to secure additional funding, we may determine that it is in our best interests to voluntarily seek relief under Chapter 11 of the U.S. Bankruptcy Code. Seeking relief under the U.S. Bankruptcy Code, even if we are able to emerge quickly from Chapter 11 protection, could have a material adverse effect on the relationships between us and our existing and potential customers, employees, and others. Further, if we were unable to implement a successful plan of reorganization, we might be forced to liquidate under Chapter 7 of the U.S. Bankruptcy Code. There can be no assurance that exploration of strategic alternatives will result in our company pursuing any particular transaction or, if we pursue any such transaction, that it will be completed.

Off-Balance Sheet Arrangements

None.

Contingencies

For a discussion of contingencies, see Note 3 of the Notes to the Condensed Consolidated Financial Statements of this report, which is incorporated herein by reference.

Item 4. **Controls and Procedures**.

(a) Evaluation of Disclosure Controls and Procedures.

Each of our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, has concluded that, based on such evaluation, our disclosure controls and procedures as of June 30, 2014, were adequate and effective to ensure that material information required to be disclosed by us in the reports that we file and submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

(b) Changes in Internal Controls.

There were no changes in our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. **OTHER INFORMATION**

Item 1. **Legal Proceedings**.

On May 1, 2014, we were informed that a complaint had been filed in the United States District Court for the Eastern District Court of Texas by Telinit Technologies, LLC against us, ACN, and ACN Communication Services claiming infringement of a patent claimed to be owned by Telinit. We were provided with a copy of the complaint but have not been formally served. We are currently investigating the matter and reviewing the alleged complaint. During the second quarter of 2014 the Company recorded a provision for the complaint.

Except as set forth above, there have been no material changes to our Legal Proceedings as described in Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on March 31, 2014.

We are not a party to any other material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which we are a party or of which any of our property is the subject.

Item 6. **Exhibits**.

See the Exhibit Index immediately following the signature page hereto for a description of the documents that are filed as exhibits to this Quarterly Report on Form 10-Q or incorporated by reference herein.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

DELTATHREE, INC.

Date: August 14, 2014	By:	/s/ Effi Baruch Name: Effi Baruch Title: Chief Executive Officer, President, Senior Vice President of Operations and Technology and Secretary (Principal Executive Officer)
Date: August 14, 2014	By:	/s/ Yochai Ozeri Name: Yochai Ozeri Title: Director of Finance and Treasurer (Principal Financial Officer)

EXHIBIT INDEX

Exhibit Number	Description
10.1	Amended and Restated Agreement Concerning Outstanding/Future Commissions and Security Agreement , dated as of June 12, 2014, among deltathree, Inc., Delta Three Israel, Ltd., DME Solutions, Inc., ACN, Inc., ACN Europe B.V. and ACN Digital Phone Service, LLC (incorporated by reference from Exhibit 10.1 to our Current Report on Form 8-K filed on June 12, 2014).
31.1	Certification of the Principal Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Principal Executive Officer, furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Principal Financial Officer, furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.*
101.SCH	XBRL Taxonomy Extension Schema Document.*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the Company specifically incorporates such information by reference.

Exhibit 31.1

CERTIFICATION BY PRINCIPAL EXECUTIVE OFFICER

I, Effi Baruch, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of deltathree, Inc. (the “registrant”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 14, 2014

By: /s/ Effi Baruch
Effi Baruch
Chief Executive Officer, President, Senior Vice President of
Operations and Technology and Secretary

Exhibit 31.2

CERTIFICATION BY PRINCIPAL FINANCIAL OFFICER

I, Yochai Ozeri, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of deltathree, Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2014

By: /s/ Yochai Ozeri
Yochai Ozeri
Director of Finance and Treasurer

Exhibit 32.1

CERTIFICATION

Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, the undersigned officer of deltathree, Inc. (the "registrant") does hereby certify, to such officer's knowledge, that:

(1) the Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 (the "Form 10-Q") of the registrant fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
(2) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the registrant.

Date: August 14, 2014

By: /s/ Effi Baruch
Effi Baruch, Chief Executive Officer, President, Senior Vice President of Operations and Technology and Secretary

The foregoing certification will not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

Exhibit 32.2

CERTIFICATION

**Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, the undersigned officer of deltathree, Inc. (the "registrant") does hereby certify, to such officer's knowledge, that:

(1) the Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 (the "Form 10-Q") of the registrant fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
(2) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the registrant.

Date: August 14, 2014

By: /s/ Yochai Ozeri
Yochai Ozeri, Director of Finance and Treasurer

The foregoing certification will not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.