DELTATHREE INC (DDDC)

10-Q

Quarterly report pursuant to sections 13 or 15(d)
Filed on 11/09/2011
Filed Period 09/30/2011

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 September 30, 2011

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)**
224 West 35th Street, New York, N.Y.	**10001-2533**
(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 November 9, 2011, the registrant had outstanding 72,273,525 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 September 30, 2011	As of December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 224	$ 308
Restricted cash and short-term investments	135	167
Accounts receivable, net (includes $175 and $235 as of September 30, 2011, and December 31, 2010, respectively, from a related party)	419	812
Prepaid expenses and other current assets	390	406
Inventory	31	25
Total current assets	1,199	1,718
Property and equipment, net	356	398
Deposits	78	80
Total assets	$ 1,633	$ 2,196
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		
Current portion of capital leases	$ -	$ 7
Accounts payable	1,334	1,554
Deferred revenues	515	659
Other current liabilities	860	1,484
Short-term loan from a related party	2,645	1,900
Total current liabilities	5,354	5,604
Long-term liabilities:		
Severance pay obligations	121	152
Total long-term liabilities	121	152
Total liabilities	5,475	5,756
Stockholders' deficiency:		
Share capital:		
Common stock, par value $0.001 per share; authorized: 225,000,000 shares; issued and outstanding: 72,273,525 at September 30, 2011, and 72,243,971 at December 31, 2010	72	72
Additional paid-in capital	176,866	174,684
Accumulated deficit	(180,780)	(178,316)
Total stockholders' deficiency	(3,842)	(3,560)
Total liabilities and stockholders' deficiency	$ 1,633	$ 2,196

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 September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Revenues	$ 2,215	$ 3,528	$ 8,205	$ 9,987
Costs and operating expenses:				
Cost of revenues	1,524	2,806	5,879	7,846
Research and development expenses	366	350	1,258	1,116
Selling and marketing expenses	424	206	1,546	681
General and administrative expenses	407	596	775	1,773
Accrual for contingency	-	176	-	176
Accrual for commercial rent tax	-	-	300	-
Depreciation and amortization	36	77	141	299
Total costs and operating expenses	2,757	4,211	9,899	11,891
Loss from operations	(542)	(683)	(1,694)	(1,904)
Interest expense, net	329	39	761	91
Loss before income taxes	(871)	(722)	(2,455)	(1,995)
Income taxes	1	7	9	19
Net loss	$ (872)	$ (729)	$ (2,464)	$ (2,014)
Net loss per share – basic and diluted	$ (0.01)	$ (0.01)	$ (0.03)	$ (0.03)
Basic and diluted weighted average number of shares outstanding	72,273,525	72,222,622	72,273,525	72,209,442

See notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2011	**2010**
Cash flows from operating activities:		
Net loss for the period	$ (2,464)	$ (2,014)
Adjustments to reconcile loss for the period to net cash used in operating activities:		
Depreciation of property and equipment	141	299
Amortization related to convertible notes	507	-
Stock-based compensation	266	314
Tax provision	(158)	-
Accumulated interest on short-term loan	154	-
Accrual for commercial rent tax	300	-
Provision for losses on accounts receivable	146	3
(Decrease) increase in liability for severance pay, net	(31)	18
Exchange rates differences on deposits, net	2	(10)
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	247	(252)
Decrease (increase) in prepaid expenses and other current assets	16	(21)
Increase in inventory	(6)	-
Decrease in accounts payable and accrued expenses	(220)	(350)
Decrease in deferred revenues	(144)	(45)
Decrease in other current liabilities	(766)	(295)
	454	(339)
Net cash used in operating activities	(2,010)	(2,353)
Cash flows from investing activities:		
Purchase of property and equipment	(99)	(69)
Increase in short-term investments	2	(2)
Net cash used in investing activities	(97)	(71)
Cash flows from financing activities:		
Release of restricted cash	30	157
Short-term loan from a related party	2,000	1,500
Payment of capital leases	(7)	(122)
Net cash provided by financing activities	2,023	1,535
Decrease in cash and cash equivalents	(84)	(889)
Cash and cash equivalents at beginning of period	308	1,514
Cash and cash equivalents at end of period	$ 224	$ 625

	Nine Months Ended September 30,	
	2011	**2010**
Supplemental schedule of cash flow information:		
Cash paid for:		
Taxes	$ 47	$ 20

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, 2010, included in our Annual Report on Form 10-K filed with the SEC on March 17, 2011, our Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, filed with the SEC on May 16, 2011, our Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, filed with the SEC on August 15, 2011, and all of our other periodic filings, including Current Reports on Form 8-K, filed with the SEC after the end of our 2010 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. The initial Loan and Security Agreement was entered into on March 1, 2010, and the Company has drawn the maximum principal amount available under the initial Loan and Security Agreement. 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 with a maximum principal amount of $1,000,000, and the Company has drawn the maximum principal amount available under the Second Loan Agreement. In connection with the Second Loan Agreement, the Company issued D4 Holdings a warrant to purchase up to 4,000,000 shares of the Company's common stock at an exercise price of $0.1312 per share. 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 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. 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 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. As of September 30, 2011, the Company had received an advance of $100,000 from D4 Holdings pursuant to a notice of borrowing under the Fourth Loan Agreement.

As of September 30, 2011, the Company had negative working capital equal to approximately $4.2 million as well as negative stockholders’ equity equal to approximately $3.8 million. The Company believes 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 addition to any further amounts it may borrow from D4 Holdings under the Fourth Loan Agreement) in the near 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.

Due to the Company's inability to generate sufficient cash flows from operations and the limited availability of additional loan advances under the Fourth Loan Agreement, the Company believes that, unless it effects a significant restructuring and materially reduces its costs and expenses, its current cash and cash equivalents will not satisfy its current projected cash requirements beyond January 2012. As a result, there is substantial doubt about the Company's ability to continue as a going concern.

In addition, unless the Company effects such a significant restructuring and materially reduces its costs and expenses, 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. If D4 Holdings is not willing to waive compliance or otherwise modify the Company's obligations such that the Company is able to avoid defaulting on such obligations, D4 Holdings could accelerate the maturity of the Company's debts due to it. Further, because D4 Holdings has a lien on all of the Company's assets to secure the Company's obligations under the loan agreements, D4 Holdings 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 37, 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 view of the Company's current cash resources, nondiscretionary expenses, debt and near term debt service obligations, the Company may begin to explore all strategic 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 it 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

Our 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.

Sales to material customers representing ten percent or more of total revenues for each of the three months ended September 30, 2011 and 2010, and accounts receivable as of September 30, 2011, and December 31, 2010, were as follows:

Customer	Revenues		Accounts Receivable	
	For the Three Months Ended September 30, 2011	For the Three Months Ended September 30, 2010	As of September 30, 2011	As of December 31, 2010
Reseller A	-	48%	-	47%
Reseller B	35%	15%	9%	7%
Reseller C	6%	1%	18%	1%
Service Provider A	11%	10%	39%	26%

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. Stock-Based Compensation

Options

Stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee’s requisite service period in accordance with the provisions of “Compensation – Stock Compensation” [ASC 718-10].

The Company has no awards with market or performance conditions.

The risk-free interest rate assumption is based upon observed interest rates appropriate for the terms of the Company’s employee stock options. The Company does not target a specific dividend yield for its dividends payments but is required to assume a dividend yield as an input to the Black–Scholes model. The dividend yield assumption is based on the Company’s history and expectation of future dividends payout and may be subject to substantial change in the future. The expected life of employee stock options represent the period the stock options are expected to remain outstanding. The Black-Scholes model assumes that an employee’s exercise behavior is a function of the option’s remaining contractual life and the extent to which the option is in-the-money (i.e., the average market price of the underlying stock during the period is above the strike price of the stock option).

Options to purchase 4,410,000 shares of the Company’s common stock were granted during the three months ended September 30, 2011.

3. Commitments and Contingencies

Lease Commitments

The Company leases its executive offices at 224 West 35th Street, New York, N.Y. The term of the lease expired on August 31, 2011, and the Company is continuing to lease the offices on a monthly basis through November 2011. The Company is currently looking for a suitable new location for its offices. Rent expense, net, for the three months ended September 30, 2011, was $6,150.

Delta Three Israel Ltd., a wholly-owned subsidiary of the Company, leases an office that houses the Company’s research and development facilities in Jerusalem, Israel. The term of the lease is until June 30, 2012, with an option for the subsidiary to extend the lease through June 30, 2015. Rent expense, net for the subsidiary for the three months ended September 30, 2011, was $46,000.

Legal Proceedings

On August 31, 2010, the U.S. Department of Homeland Security, or the DHS, seized approximately $176,000 held in the Company's bank accounts in connection with its investigation into the activities of certain of the Company's resellers. In subsequent conversations with the Assistant United States Attorney for the Eastern District of New York, or the U.S. Attorney, which is assisting the DHS in the investigation, the Company was informed that the government suspects that these resellers were engaged in money laundering activities. In addition, the U.S. Attorney stated that the Company failed to file certain reports of cash payments under applicable law. The Company is opposing this seizure, and on October 12, 2010, it filed a petition with the DHS for the return of the money. On February 4, 2011, the Company's petition was denied, and on February 22, 2011, the Company presented an offer of compromise. On November 1, 2011, the Company was notified that its offer had been denied. The Company has the right to seek judicial action or present a revised offer of compromise by November 30, 2011, and has begun informal discussions with officials at the DHS as to the terms of an offer of compromise that would be acceptable to the DHS and the Company. In accordance with FASB Statement 5, "Loss Contingencies" [ASC 450-20], the Company accounted for the seizure as a loss contingency that is probable of occurrence and recognized a loss in the entire amount seized. Any recovery of the seized amounts would be recognized as a reversal of the loss recognized.

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 has engaged outside counsel, which has begun discussions with the Department of Finance, and is contesting the assessment and simultaneously attempting to negotiate a significant reduction in the amounts to be paid. The final outcome of this assessment and our negotiations 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. The Company has recorded $300,000 as a provision for commercial rent tax.

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 $47,000 of state and local taxes and other fees during the three months ended September 30, 2011. 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 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.

4. **Warrants and Convertible Note**

As discussed above under "Basis of Presentation", the Company issued to D4 Holdings a warrant in connection with the Second Loan Agreement and a warrant and the Convertible Note in connection with the Third Loan Agreement. The Company evaluated the warrants in accordance with "Contracts in Entity's Own Equity" [ASC 815-40] and determined that the warrants should be classified as equity and should not be considered derivatives. The Company accounted for the Convertible Note in accordance with "Debt with Conversion and Other Options" [ASC 470-20], which requires the Company to recognize separately, at issuance, the embedded beneficial conversion feature of the Convertible Note as additional paid-in capital. The amount to be recognized is calculated as the difference between the effective conversion price of the convertible instrument and the fair value of the underlying shares on the issuance date. As a result, the Convertible Note was initially recorded as having no value as the beneficial conversion feature exceeded the carrying value of the Convertible Note.

5. **Subsequent Events**

In February 2011, the Company's then-largest reseller temporarily suspended its operations and conducting business with the Company due to the recent unrest in the Middle East and ongoing instability and operating difficulties caused by such unrest. At that time this reseller owed the Company approximately $196,000 for services it had rendered, and the Company recorded a provision of the entire outstanding amount for losses on accounts receivable. In September 2011, this reseller paid the Company $50,000 towards the outstanding amount, and the Company reduced the provision for losses on accounts receivable for the three months ended September 30, 2011, by such amount.

In October 2011, this reseller paid the Company an additional $100,000 towards the outstanding amount. The Company intends to reduce the provision for losses on accounts receivable for the three months ending December 31, 2011, by such amount and in the amount of any additional payments towards the outstanding amount that this reseller may make during such time.

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, 2010.

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 near term to finance operations;
- our ability to reduce our costs and expenses and expand our revenues;
- our ability to meet our obligations under outstanding indebtedness, and the impact of any remedies our secured lender may seek thereunder;
- our ability to successfully pursue strategic alternatives in the event we are unable to obtain additional financing in the near term;
- 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 dependence on a small number of key customers for a significant percentage of our revenue;
- decreasing rates of all related telecommunications services;
- the public's acceptance of Voice over Internet Protocol, or VoIP, telephony, 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 operate in international markets;
- 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;
- our ability to successfully seek the return of substantially all of the funds seized by the Department of Homeland Security;
- 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, as well as the ability of certain of our major customers operating in that region to resume or continue operations;
- 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, 2010, as filed with the SEC on March 17, 2011, as updated in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, filed with the SEC on May 16, 2011, and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, filed with the SEC on August 15, 2011. 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 new cellular phone application providing low cost mobile calls over 3G cellular networks as well as WiFi networks), iConnectHere offering (which provides VoIP products and services directly to consumers and small businesses online using the same primary platform) and our joip offering (which serves as the exclusive VoIP service provider embedded in the Globarange cordless phones of Panasonic Communications). 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.

As a result of the development and successful integration of these services, we believe that our full suite of service offerings constitutes a complete next generation communication service package that provides our customers the ability to customize, implement and rapidly launch digital next generation communications offerings.

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 2010 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. We also re-launched our sales and marketing efforts, hiring a Vice President of Business Development and Sales, and expanded our sales and marketing capabilities.

As of September 30, 2011, we had negative working capital equal to approximately $4.2 million as well as negative stockholders' equity equal to approximately $3.8 million. We believe 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 addition to any further amounts we may borrow from D4 Holdings under the Fourth Loan Agreement) in the near 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 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.

Due to our inability to generate sufficient cash flows from operations and the limited availability of additional loan advances under the Fourth Loan Agreement, we believe that, unless we effect a significant restructuring and materially reduces our costs and expenses, our current cash and cash equivalents will not satisfy our current projected cash requirements beyond January 2012. As a result, there is substantial doubt about our ability to continue as a going concern.

In addition, unless we effect such a significant restructuring and materially reduce our costs and expenses, 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. 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, D4 Holdings could accelerate the maturity of our debts due to it. Further, because D4 Holdings has a lien on all of our assets to secure our obligations under the loan agreements, D4 Holdings could take actions under the loan agreements and seek to take possession of or sell our assets to satisfy the Company's 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 our 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 37, reduced the salaries of all remaining employees by five percent, and decreased our non-material expenses as well as payments to be made to vendors and other third parties.

In view of our current cash resources, nondiscretionary expenses, debt and near term debt service obligations, we may begin to explore all strategic 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, 2010, as filed with the SEC on March 17, 2011, as updated in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2011, filed with the SEC on May 16, 2011.

Revenues

Our revenues are derived mainly from resellers, service providers, and direct consumers of our video and voice-over-IP products and services. All revenues are recognized at the time the services are performed. The provision of video and voice-over-IP products and services through our resellers and service provider divisions accounted for approximately 71% and 91% of our total revenues for the three months ended September 30, 2011 and 2010, respectively, and the provision of VoIP telephony through our direct-to-consumer division accounted for approximately 28% and 8% of our total revenues for the three months ended September 30, 2011 and 2010, respectively.

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 corporate customers and advertising and promotional expenses incurred to attract potential customers to our direct-to-consumer divisions. 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 September 30, 2011. 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 September 30, 2011, we had net operating losses, or NOLs, generated in the U.S. of approximately $165 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 will expire at various dates between 2011 and 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 September 30, 2011, Compared to Three Months Ended September 30, 2010

Revenues

Revenues decreased by approximately $1.3 million, or 37.1%, to approximately $2.2 million for the three months ended September 30, 2011, from approximately $3.5 million for the three months ended September 30, 2010. Revenues declined even though during this period the number of minutes carried by our network increased by approximately 16% to approximately 93 million minutes for the three months ended September 30, 2011, from approximately 80 million minutes for the corresponding period in 2010. This was due to a change in the relative mix of the destinations of the calls placed over our network, with a higher percentage of calls being made during the three months ended September 30, 2011, to destinations for which we charge significantly lower rates than during the three months ended September 30, 2010. This was caused, in large part, by the temporary cessation of services to our then-largest reseller beginning in February 2011, for which we terminated a large number of calls to higher-rate destinations. In September 2011, this reseller resumed operations and conducting business with our company. We believe that this reseller will become a material customer of the company again beginning in the fourth quarter of 2011.

Revenues generated by our reseller division decreased by approximately $1.5 million, or 51.9%, to approximately $1.3 million for the three months ended September 30, 2011, from approximately $2.8 million for the three months ended September 30, 2010. This was primarily due to our then-largest reseller (which accounted for revenues of approximately $1.7 million for the three months ended September 30, 2010) temporarily suspending its operations and conducting business with our company beginning in February 2011 due to the recent unrest in the Middle East and ongoing instability and operating difficulties caused by such unrest. At that time this reseller owed us approximately $196,000 for services we had rendered, and we recorded a provision of the entire outstanding amount for losses on accounts receivable. In September 2011, this reseller paid us $50,000 towards the outstanding amount, and we reduced the provision for losses on accounts receivable for the three months ended September 30, 2011, by such amount. In October 2011, this reseller paid us an additional $100,000 towards the outstanding amount.

This decrease in revenues was partially offset by an increase of approximately $260,000 in revenues generated by our current-largest reseller over the corresponding period. Our two largest resellers accounted for approximately 70.4% of the revenue generated from our reseller division and approximately 40.6% of our total revenue during the three months ended September 30, 2011. By comparison, our two largest resellers accounted for approximately 80.0% of the revenue generated from our reseller division and approximately 62.9% of our total revenue during the three months ended September 30, 2010.

Revenues generated by our service provider division decreased by approximately $145,000, or 33.4%, from approximately $431,000 for the three months ended September 30, 2010, to approximately $286,000 for the three months ended September 30, 2011. This decrease was mostly due to the termination of service to Ojo Service, LLC that occurred at the beginning of the third quarter of 2011 as a result of Ojo Service ceasing to provide service to its customers.

Sales to direct consumers increased by approximately $331,000, or 113%, to approximately $622,000 for the three months ended September 30, 2011, from approximately $291,000 for the three months ended September 30, 2010. Revenues generated through our iConnectHere offering declined by approximately $73,000 from approximately $272,000 for the three months ended September 30, 2010, to approximately $199,000 for the three months ended September 30, 2011. This was offset by the revenues generated by our joip Mobile offering, which increased from $0 for the three months ended September 30, 2010, to approximately $406,000 for the three months ended September 30, 2011, primarily as a result of the sales agency agreement we entered into with ACN and the introducer agreement we entered into with ACN Europe.

Costs and Operating Expenses

Cost of revenues. Cost of revenues decreased by approximately $1.3 million, or 46.4%, from approximately $2.8 million for the three months ended September 30, 2010, to approximately $1.5 million for the three months ended September 30, 2011. Our network rent cost remained approximately $300,000 and our termination cost decreased by approximately $1.4 million, or 52.2%, from approximately $2.4 million for the three months ended September 30, 2010, to approximately $1.0 million for the three months ended September 30, 2011. The main reason for the decrease in cost of revenues was the reduction in our termination costs, which was caused by a decrease in the rates we paid to our termination providers, despite an increase in the amount of traffic being terminated over our network.

Research and development expenses. Research and development expenses increased by approximately $16,000, or 4.6%, from approximately $350,000 for the three months ended September 30, 2010, to approximately $366,000 for the three months ended September 30, 2011. The main reason for the increase was the growth in the number of employees in our research and development department, as well as higher salary expenses for our employees in such department. As a percentage of revenues, research and development expenses increased to 16.5% for the three months ended September 30, 2011, from 9.9% for the three months ended September 30, 2010.

Selling and marketing expenses. Selling and marketing expenses increased by approximately $218,000, or 106%, to approximately $424,000 for the three months ended September 30, 2011, from approximately $206,000 for the three months ended September 30, 2010. The main reason for the increase was salaries paid to new members of our sales and marketing department and commissions accrued to be paid to ACN in connection with the ACN Mobile World offering. As a percentage of revenues, selling and marketing expenses increased to 19.1% for the three months ended September 30, 2011, from 5.8% for the three months ended September 30, 2010.

General and administrative expenses. General and administrative expenses decreased by approximately $189,000 to approximately $407,000 for the three months ended September 30, 2011, from approximately $596,000 for the three months ended September 30, 2010. During the three months ended September 30, 2011, we reversed $50,000 from the provision of $196,000 for losses on accounts receivable we had previously recorded in connection with outstanding amounts owed to us by one of our resellers. Excluding this reversal of a portion of our reserve, our general and administrative expenses would have decreased in the three months ended September 30, 2011, by approximately $139,000 from the three months ended September 30, 2010, primarily due to a reallocation of our human resources and a resulting adjustment of our cost allocation that occurred in the fourth quarter of 2010.

Depreciation and amortization. Depreciation and amortization decreased by approximately $41,000, or 53.2%, from approximately $77,000 for the three months ended September 30, 2010, to approximately $36,000 for the three months ended September 30, 2011. This was caused by a decline in the value of our fixed assets during this period.

Loss from Operations

For the three months ended September 30, 2011, we recorded loss from operations of approximately $542,000 compared to a loss from operations of approximately $683,000 for the three months ended September 30, 2010, due to the factors set forth above.

Interest Expense, Net

We recorded interest expense of approximately $329,000 for the three months ended September 30, 2011, compared to approximately $39,000 for the three months ended September 30, 2010. This was due primarily to interest accrued to be paid to D4 Holdings under our loan agreements with D4 Holdings, and the expense recorded for 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 approximately $1,000 for the three months ended September 30, 2011, compared to approximately $7,000 for the three months ended September 30, 2010.

Net Loss

For the three months ended September 30, 2011, we recorded a net loss of approximately $872,000 compared to a net loss of approximately $729,000 for the three months ended September 30, 2010, due to the factors set forth above.

Results of Operations - Nine Months Ended September 30, 2011, Compared to Nine Months Ended September 30, 2010

Revenues

Revenues decreased by approximately $1.8 million, or 18.0%, to approximately $8.2 million for the nine months ended September 30, 2011, from approximately $10.0 million for the nine months ended September 30, 2010. Revenues declined even though during this period the number of minutes carried by our network increased by approximately 26.8% to approximately 279 million minutes from approximately 220 million minutes for the corresponding period of 2010. This was due to a change in the relative mix of the destinations of the calls placed over our network, with a higher percentage of calls being made during the nine months ended September 30, 2011, to destinations for which we charge significantly lower rates than during the nine months ended September 30, 2010. This was caused, in large part, by the temporary cessation of services to our then-largest reseller beginning in February 2011, for which we terminated a large number of calls to higher-rate destinations. In September 2011, this reseller resumed operations and conducting business with our company. We believe that this reseller will become a material customer of the company again beginning the three months ended December 31, 2011.

Revenues generated by our reseller division decreased by approximately $2.5 million, or 31.6%, to approximately $5.4 million for the nine months ended September 30, 2011, from approximately $7.9 million for the nine months ended September 30, 2010. This was primarily due to our then-largest reseller (which accounted for revenues of approximately $4.6 million and $1.4 million for the nine months ended September 30, 2010, and 2011, respectively) temporarily suspending its operations and conducting business with our company beginning in February 2011 due to the recent unrest in the Middle East and ongoing instability and operating difficulties caused by such unrest. At that time this reseller owed us approximately $196,000 for services we had rendered, and we recorded a provision of the entire outstanding amount for losses on accounts receivable. In September 2011, this reseller paid us $50,000 towards the outstanding amount, and we reduced the provision for losses on accounts receivable for the nine months ended September 30, 2011, by such amount. In October 2011, this reseller paid us an additional $100,000 towards the outstanding amount.

This decrease in revenues was partially offset by an increase of approximately $1.1 million in revenues generated by our current-largest reseller over the corresponding period. Our two largest resellers accounted for approximately 71.8% of the revenue generated from our reseller division and approximately 47.1% of our total revenue during the nine months ended September 30, 2011. By comparison, our two largest resellers accounted for approximately 75.2% of the revenue generated from our reseller division and approximately 59.2% of our total revenue during the nine months ended September 30, 2010.

Revenues generated by our service provider division increased by approximately $30,000, or 2.8%, from approximately $1.06 million for the nine months ended September 30, 2010, to approximately $1.09 million for the nine months ended September 30, 2011. This increase was mostly due to the revenues generated from the service agreement we signed with ACN Korea pursuant to which we provide digital video and voice-over-IP services in Korea, which accounted for revenues of approximately $187,000 for the nine month period ended September 30, 2011, including $100,000 in one-time development fees. We also received $40,000 in one-time development fees from some of our other service provider clients. This increase was offset by a decrease of approximately $200,000 in revenues due to termination of service to Ojo Service that occurred at the beginning of the third quarter of 2011 as a result of Ojo Service ceasing to provide service to its customers as well as a decline in revenues from some of our other service provider clients.

Sales to direct consumers increased by approximately $600,000, or 60%, to approximately $1.6 million for the nine months ended September 30, 2011, from approximately $1.0 million for the nine months ended September 30, 2010. Revenues generated through our iConnectHere offering declined by approximately $266,000 from approximately $966,000 for the nine months ended September 30, 2010, to approximately $700,000 for the nine months ended September 30, 2011. This was offset by the revenues generated by our joip Mobile offering, which increased from $0 for the nine months ended September 30, 2010, to approximately $874,000 for the nine months ended September 30, 2011, primarily as a result of the sales agency agreement we entered into with ACN and the introducer agreement we entered into with ACN Europe.

Costs and Operating Expenses

Cost of revenues. Cost of revenues decreased by approximately $1.9 million, or 24.4%, from approximately $7.8 million for the nine months ended September 30, 2010, to approximately $5.9 million for the nine months ended September 30, 2011. Our network rent cost remained approximately $891,000 and our termination cost decreased by approximately $1.9 million, or 29.7%, from approximately $6.4 million for the nine months ended September 30, 2010 to approximately $4.5 million for the nine months ended September 30, 2011. The main reason for the decrease in cost of revenues was the reduction in our termination costs, which was caused by a decrease in the rates we paid to our termination providers, despite an increase in the amount of traffic being terminated over our network.

Research and development expenses. Research and development expenses increased by approximately $200,000, or 18.2%, from approximately $1.1 million for the nine months ended September 30, 2010, to approximately $1.3 million for the nine months ended September 30, 2011. The main reason for the increase was the growth in the number of employees in our research and development department, as well as higher salary expenses for our employees in such department. As a percentage of revenues, research and development expenses increased to 15.3% for the nine months ended September 30, 2011, from 11.2% for the nine months ended September 30, 2010.

Selling and marketing expenses. Selling and marketing expenses increased by approximately $865,000, or 127%, to approximately $1.5 million for the nine months ended September 30, 2011, from approximately $681,000 for the nine months ended September 30, 2010. The main reason for the increase was salaries paid to new members of our sales and marketing department and commissions accrued to be paid to ACN in connection with the ACN Mobile World offering. As a percentage of revenues, selling and marketing expenses increased to 18.8% for the nine months ended September 30, 2011, from 11.2% for the nine months ended September 30, 2010.

General and administrative expenses. General and administrative expenses decreased by approximately $1.0 million to approximately $800,000 for the nine months ended September 30, 2011, from approximately $1.8 million for the nine months ended September 30, 2010. This was due primarily to a reversal of an accrual of $706,000 for expenses expected to arise from our litigation with Centre One and the reversal of an accrual for tax liability of $158,000. This was partially offset by $146,000 we recorded as a provision for losses on accounts receivable in connection with outstanding amounts owed to us by one of our resellers. Excluding these items, our general and administrative expenses would have decreased in the nine months ended September 30, 2011, by approximately $280,000 from the nine months ended September 30, 2010, primarily due to a reallocation of our human resources and a resulting adjustment of our cost allocation that occurred in the fourth quarter of 2010.

Accrual for commercial rent tax. For the nine months ended September 30, 2011, we recorded $300,000 as a provision for tax liability. On July 5, 2011, we received a notice from the Department of Finance, which 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.

Depreciation and amortization. Depreciation and amortization decreased by approximately $158,000, or 52.8%, from approximately $299,000 for the nine months ended September 30, 2010, to approximately $141,000 for the nine months ended September 30, 2011. This was caused by a decline in the value of our fixed assets during this period.

Loss from Operations

For the nine months ended September 30, 2011, we recorded loss from operations of approximately $1.7 million compared to a loss from operations of approximately $1.9 million for the nine months ended September 30, 2010, due to the factors set forth above.

Interest Expense, Net

We recorded interest expense of approximately $761,000 for the nine months ended September 30, 2011, compared to approximately $91,000 for the nine months ended September 30, 2010. This was due primarily to interest paid or accrued to be paid to D4 Holdings under our loan agreements with D4 Holdings, and the expense recorded for 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 approximately $9,000 for the nine months ended September 30, 2011, compared to approximately $19,000 for the nine months ended September 30, 2010.

Net Loss

For the nine months ended September 30, 2011, we recorded a net loss of approximately $2.5 million compared to a net loss of approximately $2.0 million for the nine months ended September 30, 2010, 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 recent losses from operations. For the nine months ended September 30, 2011, we recorded a net loss from operations of approximately $1.7 million compared to a net loss of approximately $1.9 million for the nine months ended September 30, 2010. To date, we have an accumulated deficit of approximately $181 million.

As of September 30, 2011, we had cash and cash equivalents of approximately $224,000 and restricted cash and short-term investments of approximately $135,000, or a total of cash, cash equivalents and restricted cash of $359,000, a decrease of $116,000 from December 31, 2010. The decrease in cash, restricted cash, and short and long term investments was primarily caused by approximately $2.0 million in net cash used in operating activities during the nine months ended September 30, 2011. Our average monthly cash burn during the nine months ended September 30, 2011, was approximately $220,000. We believe that, as a result of the recent restructuring and cost-cutting measures we have implemented our monthly cash burn during the three months ended December 31, 2011, will be approximately $80,000.

Cash used in or provided by operating activities is net income adjusted for certain non-cash items and changes in assets and liabilities. We had negative cash flow from operating activities of approximately $2.0 million and $2.4 million during the nine months ended September 30, 2011 and 2010, respectively. The decrease in our cash generated from operating activities was primarily driven by an increase in our net loss, accrual for commercial rent tax of $300,000, provision for losses on accounts receivable of $146,000 and amortization of $507,000 related to convertible notes, offset by a decrease in accounts payables and other current liabilities of $341,000.

Net cash used in investing activities is generally driven by our capital expenditures and changes in our short and long-term investments. For the nine months ended September 30, 2011, we expensed $99,000 for purchases of new equipment, compared to $69,000 we expensed for purchases of new equipment for the nine months ended September 30, 2010.

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 $1.2 million. 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 $1.2 million. 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 our subsidiaries an additional line of credit in a principal amount of $1.0 million. In connection with the Second Loan Agreement, we issued 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 first 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 our subsidiaries an additional line of credit in a principal amount of $1.6 million. Pursuant to the terms of the Convertible Note we issued to D4 Holdings 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. 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 an aggregate of $1,600,000 from D4 Holdings pursuant to notices of borrowing 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 received advances of an aggregate of $150,000 from D4 Holdings pursuant to notices of borrowing under the Fourth Loan Agreement.

There were no options exercised by our employees or directors during the three months ended September 30, 2011. For the nine months ended September 30, 2011 and 2010, we paid approximately $7,000 and $122,000, respectively, for capital leases.

As discussed above under Note 3 of the Notes to the Condensed Consolidated Financial Statements contained in this report, the Department of Homeland Security, or the DHS, seized approximately $176,000 held in our bank accounts in connection with its investigation into the activities of certain of our resellers. We are opposing this seizure, and on October 12, 2010, we filed a petition with the DHS for the return of the money. On February 4, 2011, our petition was denied, and on February 22, 2011, we presented an offer of compromise. On November 1, 2011, we were notified that our offer had been denied. We have the right to seek judicial action or present a revised offer of compromise by November 30, 2011, and have begun informal discussions with officials at the DHS as to the terms of an offer of compromise that would be acceptable to the DHS and us. Our inability to access these funds has had a material impact on our cash position and liquidity. In the event that we are unsuccessful in effecting the return of substantially all of the seized funds, this would have a material adverse effect on our business, liquidity and financial condition.

In addition, at the end of February 2011 our then-largest reseller temporarily suspended its operations and conducting business with our company due to the recent unrest in the Middle East and ongoing instability and operating difficulties caused by such unrest. At that time this reseller owed us approximately $196,000 for services we had rendered, and we recorded a provision of the entire outstanding amount for losses on accounts receivable. In September 2011, this reseller paid us $50,000 towards the outstanding amount, and we reduced the provision for losses on accounts receivable by such amount. In October 2011, this reseller paid us an additional $100,000 towards the outstanding amount. Also in September 2011, this reseller resumed operations and conducting business with our company. We believe that this reseller will become a material customer of the company again beginning in the fourth quarter of 2011.

On July 5, 2011, we received a notice from the Department of Finance, which 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 the company 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 have engaged outside counsel, which has begun discussions with the Department of Finance, and we are contesting the assessment and simultaneously attempting to negotiate a significant reduction in the amounts to be paid. The final outcome of this assessment and our negotiations cannot be determined at this time. In the event that we are required to pay all or most of the amounts claimed by the Department of Finance this would have a material adverse effect on our financial condition and liquidity. We previously 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.

As of September 30, 2011, we had negative working capital equal to approximately $4.2 million as well as negative stockholders' equity equal to approximately $3.8 million. We believe that we will continue to experience losses and increased negative working capital and negative stockholders' equity in the near future, and that we will not be able to return to positive cash flow before we require additional capital (in addition to any further amounts we may borrow from D4 Holdings under the Fourth Loan Agreement) in the near term. We may experience difficulties accessing the equity and debt markets and raising such 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 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.

Due to our inability to generate sufficient cash flows from operations and the limited availability of additional loan advances under the Fourth Loan Agreement, we believe that, unless we effect a significant restructuring and materially reduces our costs and expenses, our current cash and cash equivalents will not satisfy our current projected cash requirements beyond January 2012. As a result, there is substantial doubt about our ability to continue as a going concern.

In addition, unless we effect such a significant restructuring and materially reduce our costs and expenses, 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. 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, D4 Holdings could accelerate the maturity of our debts due to it. Further, because D4 Holdings has a lien on all of our assets to secure our obligations under the loan agreements, D4 Holdings could take actions under the loan agreements and seek to take possession of or sell our assets to satisfy the Company's 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 our 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 37, reduced the salaries of all remaining employees by five percent, and decreased our non-material expenses as well as payments to be made to vendors and other third parties.

In view of our current cash resources, nondiscretionary expenses, debt and near term debt service obligations, we may begin to explore all strategic 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 September 30, 2011, 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**.

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, 2010, as filed with the SEC on March 17, 2011, and as supplemented by our Quarterly Report on Form 10-Q for the period ended March 31, 2011, and our Quarterly Report on Form 10-Q for the period ended June 30, 2011, except as described below.

On November 1, 2011, we were notified by the DHS that our offer of compromise had been denied. We have the right to seek judicial action or present a revised offer of compromise by November 30, 2011, and have begun informal discussions with officials at the DHS as to the terms of an offer of compromise that would be acceptable to the DHS and us.

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 Exhibit Index on page 24 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: November 9, 2011	By:	/s/ Effi Baruch Name: Effi Baruch Title: Chief Executive Officer, President and Senior Vice President of Operations and Technology (Principal Executive Officer)
Date: November 9, 2011	By:	/s/ Arie Rand Name: Arie Rand Title: Chief Financial Officer and Treasurer (Principal Financial Officer)

EXHIBIT INDEX

Exhibit Number	Description
4.1	Promissory Note, dated September 12, 2011, by deltathree, Inc., Delta Three Israel, Ltd. and DME Solutions, Inc. in favor of D4 Holdings, LLC in a principal amount of $300,000 (incorporated by reference from our Current Report on Form 8-K filed on September 12, 2011).
10.1	Amendment No. 4 to Executive Employment Agreement among deltathree, Inc., Delta Three Israel, Ltd. and Effi Baruch, dated as of August 17, 2011.
10.2	Amendment No. 2 to Offer of Employment Letter between Delta Three Israel, Ltd. and Arie Rand, dated August 17, 2010.
10.3	Fourth Loan and Security Agreement, dated as of September 12, 2011, by and among deltathree, Inc., Delta Three Israel, Ltd., DME Solutions, Inc. and D4 Holdings, LLC (incorporated by reference from our Current Report on Form 8-K filed on September 12, 2011).
31.1	Certification of the Chief Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief 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 Chief Financial Officer, furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

AMENDMENT NO. 4 TO EXECUTIVE EMPLOYMENT AGREEMENT

This Amendment No. 4 to Executive Employment Agreement by and between deltathree, Inc., a Delaware corporation ("Inc.") and Delta Three Israel, Ltd., an Israeli corporation ("Ltd.", and together with Inc., the "Company"), on the one hand, and Effi Baruch, an individual ("Executive") on the other hand, dated as of December 9, 2008 (the "Executive Employment Agreement"), as amended by that certain Amendment No. 1, dated as of March 17, 2009 ("Amendment No. 1"), that certain Amendment No. 2, dated as of October 20, 2009 ("Amendment No. 2"), and that certain Amendment No. 3, dated as of October 27, 2010 ("Amendment No. 3", and together with the Executive Employment Agreement, Amendment No. 1 and Amendment No. 2, the "Agreement"), is dated as of August 17, 2011.

Recitals:

WHEREAS, the Company and Executive entered into the Executive Employment Agreement, as amended by Amendment No. 1, Amendment No. 2 and Amendment No. 3, and now wish to enter into this Amendment No. 3 to Executive Employment Agreement ("Amendment No. 4") to further amend the Agreement as set forth below;

NOW, THEREFORE, in consideration of the foregoing and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto, intending to be legally bound, hereby agree as follows:

1. The first sentence of Section 3(a) of the Agreement is hereby deleted in its entirety and replaced with the following:

"During the Employment Period, the Company shall pay Executive a base salary at the annual rate of U.S.$180,735.60 ($15,061.30 per month, or the pro rata portion thereof), payable in accordance with the Company's customary payroll practices (the "Base Salary")."

2. The foregoing amendment to the Agreement shall be effective commencing as of August 1, 2011.

3. Except as expressly provided in this Amendment No. 4, all of the terms and conditions of the Agreement remain unchanged, and the terms and conditions of the Agreement as amended hereby remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment No. 4 as of the date first set forth above.

DELTATHREE, INC.

By: /s/ Robert Stevanovski
Name: Robert Stevanovski
Title: Chairman of the Board

DELTA THREE ISRAEL, LTD.
By: deltathree, Inc., its sole director

By: /s/ Robert Stevanovski
Name: Robert Stevanovski
Title: Chairman of the Board

/s/ Effi Baruch
Effi Baruch

AMENDMENT NO. 2 TO OFFER OF EMPLOYMENT LETTER

This Amendment No. 2 ("Amendment No.2") to Offer of Employment Letter by and between Delta Three Israel, Ltd. (the "Company") and Arie Rand ("Executive"), dated as of September 19, 2010 (the "Offer of Employment Letter"), as amended by Amendment No. 1 to Offer of Employment Letter, dated as of October 17, 2010 ("Amendment No. 1", and together with the Offer of Employment Letter, the "Agreement"), is dated as of August 17, 2011.

Recitals:

WHEREAS, the Company and Executive entered into the Offer of Employment Letter, as amended by Amendment No. 1, and now wish to enter into this Amendment No. 2 to Offer of Employment Letter ("Amendment No. 2") to further amend the Agreement as set forth below;

NOW, THEREFORE, in consideration of the foregoing recital and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto, intending to be legally bound, hereby agree as follows:

1. The clause "10,000 USD (with payment in NIS at an exchange rate of 4 NIS for 1 USD)." found on page 2 of the Agreement is hereby deleted in its entirety and replaced with "38,000 NIS."

2. The foregoing amendment to the Agreement shall be effective as of August 1, 2011.

3. Except as expressly provided in this Amendment No. 2, all of the terms and conditions of the Agreement remain unchanged, and the terms and conditions of the Agreement remain in full force and effect.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment No. 2 as of the date first set forth above.

DELTA THREE ISRAEL, LTD.

By: /s/ Effi Baruch
Name: Effi Baruch
Title: Chief Executive Officer and President

/s/ Arie Rand
Arie Rand

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: November 9, 2011

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

Exhibit 31.2

CERTIFICATION BY PRINCIPAL FINANCIAL OFFICER

I, Arie Rand, 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: November 9, 2011

By: /s/ Arie Rand
Arie Rand
Chief Financial Officer 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 September 30, 2011 (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: November 9, 2011	By:	/s/ Effi Baruch
		Effi Baruch, Chief Executive Officer, President and Senior Vice President of Operations and Technology

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 September 30, 2011 (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: November 9, 2011

By: /s/ Arie Rand
Arie Rand, Chief Financial Officer 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.