



FORM 10-K

DELTATHREE INC - DDDC

Filed: March 31, 2008 (period: December 31, 2007)

Annual report which provides a comprehensive overview of the company for the past year

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

FORM 10-K

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

For the Fiscal Year Ended December 31, 2007, or

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

For the transition period from _____ to _____

Commission File Number: 000-28063

DELTATHREE, INC.

(Exact name of registrant as specified in charter)

Delaware

(State or other jurisdiction of incorporation or organization)

13-4006766

(I.R.S. employer identification no.)

75 Broad Street, 31st Floor

New York, New York

(Address of principal executive offices)

10004

(Zip code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which the Securities are Registered
Class A Common Stock, par value \$0.001 per share	OTC Bulletin Board

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by a 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the Class A Common Stock held by non-affiliates of the Registrant based upon the closing price of the Class A Common Stock as reported by the Nasdaq Stock Market on June 29, 2007 (the last business day of the Registrant's most recently completed second fiscal quarter) was \$25,041,517. Solely for purposes of this calculation, shares beneficially owned by

directors and officers of the Registrant and persons owning 5% or more of the Registrant's Class A Common Stock have been excluded, in that such persons may be deemed to be affiliates of the Registrant. Such exclusion should not be deemed a determination or admission by the Registrant that such individuals or entities are, in fact, affiliates of the Registrant.

As of March 28, 2008, the Registrant had outstanding 32,870,105 shares of Class A Common Stock, par value \$0.001 per share.

Documents incorporated by reference: None

DELTATHREE, INC.
2007 ANNUAL REPORT ON FORM 10-K

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PART I

The statements contained in this Annual Report on Form 10-K, or Annual Report, that are not descriptions of historical facts may be 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 "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," 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. Please see the section below entitled "Risk Factors" for detailed information about the uncertainties and other factors that may cause actual results to materially differ from the views stated in such forward-looking statements. All forward-looking statements and risk factors included in this Annual Report are made as of the date hereof, based on information available to us as of the date hereof, and we assume no obligation to update any forward-looking statement or risk factor, whether as a result of new information, future events, changes in assumptions or otherwise.

Our fiscal year ends on December 31 of each calendar year. Each reference to a fiscal year in this Annual Report refers to the fiscal year ending December 31 of the calendar year indicated. Unless the context requires otherwise, references to "we," "us," "our," "the Company," and "deltathree" refer to deltathree, Inc. and its subsidiary deltathree, Ltd., collectively.

ITEM 1. BUSINESS

Company Overview

We are a leading provider of integrated 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. IP telephony, or 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 one of the premier providers of next generation communication services in the world.

Today we support tens of thousands of active users around the globe through our two primary distribution channels: our service provider and reseller channel and our direct-to-consumer channel. We offer a broad suite of private label VoIP products and services as well as a back-office platform for service providers, resellers, and corporate customers, such as incumbent telecommunications providers, Internet service providers, or ISPs, cable companies, licensed VoIP operators, and various corporate enterprises. Based on our customizable VoIP solutions, these customers can offer private label telecommunications to their own customer bases under their own brand name, a "white-label" brand (where no brand name is indicated and different customers can offer the same product), our iConnectHere, or ICH, brand, or the deltathree brand. At the same time, our direct-to-consumer channel includes our iConnectHere offering (which provides VoIP products and services directly to consumers and small businesses online using the same primary platform) and our recently established joip offering (which serves as the exclusive VoIP service provider embedded in the Globarange cordless phones of Panasonic Communications Co., Ltd., or Panasonic, the world leader in consumer cordless phones). This joip-enabled phone first became available in August 2007 and is currently available in the United States, Canada, United Kingdom and Ireland, Germany, Spain and Austria.

We have built a privately-managed, state-of-the-art global telecommunications platform using IP technology and offer our customers a unique suite of IP telephony products, including PC-to-Phone and Broadband Phone products. We differentiate ourselves from our competitors by providing a robust set of value-added services and features that enable us to effectively address the challenges that have traditionally made the provision of telecommunications services difficult, and we offer our products and services to a global customer base in a fashion that meets the disparate needs of this diverse customer base. 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. 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. For example, we released a next generation SIP-based PC-to-Phone application, certified many new

devices which function as access points to our services, and added new features and new calling plans to our offerings.

In 2004, we announced our first major service provider contract, with Verizon Communications Inc. Since then, we have remained focused on increasing the market penetration of our core VoIP solutions and continuing to diversify and expand our customer base. For example, we diversified our base in 2006 by adding customers for our Hosted Consumer VoIP Solution in markets such as instant messaging and cellular telecommunications. In 2007, we entered into an agreement with Market America, a leading on-line shopping and one-to-one marketing company, pursuant to which Market America launched its Voitel Home Phone Service powered by our Hosted Consumer VoIP Solution platform. In addition, we entered into an agreement with RCN Corporation, a leading provider of video, data, and voice services to residential, business, and commercial/carrier customers, to power its new Starpower Internet Phone Service. As a result, we continued to sell an increasingly diverse set of VoIP products and services to our growing Service Provider and Reseller base. Our product strategy for reaching these customers focused on enhancing our service delivery offering suite by successfully launching customizable modular and comprehensive VoIP solutions, adding new features to our VoIP products, launching new distribution lines for our consumer group, and upgrading our network capacity and features.

As a complement to the initiatives we have taken to organically expand our businesses, we have also been evaluating opportunities for inorganic growth through strategic acquisitions and unique collaborations. In February 2007, we acquired the service provider and consumer business assets including the customer bases of Go2Call.com, Inc., a privately held U.S.-based VoIP solutions provider, for cash and our stock valued at approximately \$7.0 million. Moreover, we expect that our strategic collaboration with Panasonic, including our joint offering, will present opportunities for growth as we expand into another market by enabling Panasonic's Globalrange cordless phones to deliver our VoIP services to consumers in various countries worldwide.

Going forward, we expect to:

- continue to devote our resources to develop and expand our Service Provider and Reseller base and we expect our revenue from this key channel to represent a significant percentage of our total revenue in the foreseeable future;
- actively market our products and services to a large number of broadband operators, incumbent telecommunication providers, cable companies, ISPs, licensed VoIP operators, corporate enterprises, and consumer oriented retailers around the world; and
- pursue a targeted strategy of identifying and evaluating appropriate acquisition candidates and strategic collaborations that will continue to expand and diversify our customer base.

Industry Background

VoIP is increasingly becoming a widely used alternative technology that can replace services provided by a traditional telephone network. VoIP technology translates voice into data packets, transmits the packets over data networks such as the Internet or privately managed networks (such as our network), and reconverts them into voice at the destination. Unlike traditional telephone networks, VoIP does not use dedicated circuits for each telephone call; instead, the same VoIP network can be shared by multiple users for voice, data and video simultaneously. This type of data network is more efficient than a dedicated circuit network because the data network is not restricted by the one-call, one-line limitation of a traditional telephone network and, as a result, greater traffic can be transmitted over this data network. This improved efficiency creates cost savings that can be passed on to consumers in the form of lower rates or retained by the VoIP provider. Significant cost savings are also achieved for international telephone calls carried over data networks primarily because they bypass the international settlement process, which represents a significant portion of international long distance tariffs. Additionally, VoIP allows for features that are not available on traditional telephony networks - particularly at the consumer level - including voice mail to email forwarding, find me/follow me, web-based control of call forwarding preferences, user account review/revision and a host of other features and functions.

IDC, a market research firm, estimates that U.S. residential VoIP telephony subscribers will grow at a 60% compound annual growth rate from 4.3 million VoIP subscribers in 2005 to 44.0 million subscribers by the end of 2010. Beyond cost savings, we believe that VoIP telephony technologies will further the potential for the Internet to become the preferred medium of communications and commerce. As a result, VoIP has experienced significant growth in recent years due to:

- improved quality and reliability of VoIP calls due to technological advances, increased network development and greater bandwidth capacity;
- new product development that allows VoIP providers to offer services not currently offered by traditional telephone companies;
- greatly improved ease of use, whereby the end-user does not perceive a difference between use of a traditional telephone and a broadband telephone;
- increasing demand for long distance communication services driven by the increased mobility of the global workforce; and
- increasing demand for lower cost telephone service around the world.

As a result of these growth trends, various service providers, enterprises and consumers are continuing to procure offerings from VoIP providers such as deltathree. Specifically, consumers in emerging markets are increasingly using VoIP-enabled services, such as IP telephones, to realize significant cost savings on long distance and international calls, while in markets where a significant number of consumers have access to broadband internet services these consumers are increasingly viewing VoIP as a viable and more affordable substitute for their traditional telecommunications provider.

Accordingly, many of the traditional telecommunications providers are looking to deploy VoIP in addition to their current offerings in order not to lose their customers, while cable companies, ISPs and other broadband providers are looking at VoIP service offerings as a way to capture new revenue streams from existing and new customers. These providers have two primary alternative means to develop and deploy VoIP offerings: build them in-house or partner with a company like deltathree and outsource all or a portion of the effort. Those seeking to offer VoIP service offerings by developing an in-house service must learn a vastly different set of platforms and integrate several additional components with their existing systems, which requires the development of significant technical expertise and the deployment and management of substantial capital expenditures. Alternatively, a full service VoIP company, like deltathree, can provide these service providers with the ability to outsource their VoIP services, and thereby effectively reduce the upfront and ongoing cost of providing the service and efficiently reduce the time to market and risks associated with developing and maintaining an in-house VoIP service.

Our Products and Services

Products

We have built a privately-managed, global network using IP technology and offer our customers a broad range and unique suite of IP telephony products. Our VoIP products include:

PC-to-Phone. Our PC-to-Phone offering enables a user to conveniently and inexpensively place a call to a standard telephone anywhere in the world directly from a personal computer while remaining on-line. In order to use this product, a user need only download our software from our website and have access to the Internet. Once our PC-to-Phone application is downloaded and a user account is established, the user is able to place a call from the user's personal computer and, while browsing the Web, speak to a party who uses a standard telephone.

We are able to provide our PC-to-Phone offering at rates generally lower than those charged for traditional circuit switched calls. We are able to do so because our service utilizes packet-switched technology and routes calls directly from the user's Internet connection onto our privately-managed IP network and to the called destination. This avoids access and other charges associated with traditional international and domestic long distance telecommunications services.

Broadband Phone. Our Broadband Phone product is a complete phone replacement solution available to business and consumer customers over the "last mile" through broadband connections via cable modem, DSL or fixed wireless. Broadband Phone challenges the traditional public switched telephone network, or PSTN, and circuit switched networks with a full VoIP solution. With our high call quality, "always on" reliability and increased functionality provided by the high bandwidth access line, we are able to offer potential partners and their customers some of the most sophisticated VoIP solutions available in the market through a highly scalable, low-cost and easily implemented product. In addition to offering capabilities similar to those offered by traditional telephony providers and allowing users to use their existing phone, Broadband Phone enables a user to conveniently operate features and retrieve voice mail through email, web or a phone interface. For our potential partners, the turnkey or customizable solution is delivered with our full back-end infrastructure, including customer service for end users and service providers, pricing information, fulfillment, billing, provisioning, local number portability, and fraud services. Additionally, Broadband Phone is easily integrated (a variety of devices are available to plug directly into a PC or IP network) so as to allow broadband providers to begin delivering our voice solution rapidly.

Services

We differentiate ourselves from our competitors by providing a robust set of value-added services that enables us to effectively address the challenges that have traditionally made the provision of telecommunications services difficult. These operations management tools include the following:

- *account provisioning:* we provide our service provider and reseller customers with a dedicated Web page through which they can order additional services or accounts, generate and activate PINs and perform other customary implementation functions;
- *payment processing systems:* we provide our customers with a fraud detection and prevention system to permit secure credit card transactions over the Web;
- *billing and account management:* we provide our customers with real-time, Web-based access to billing records to check billing and usage information or to increase prepaid accounts;
- *customer care:* we have moved and consolidated traditional first tier customer care functions onto the Web for ease and flexibility and support this with second tier customer care via toll-free access; and

- *network operations care*: we provide a Network Operations Center, or NOC, automated trouble ticket system, which enables our customers to submit, manage, and follow-up with technical questions and issues online.

The provision of VoIP telephony products and services through our service provider and reseller sales channel accounted for 85.4% of our total revenues in 2007, while the provision of VoIP telephony through our direct-to-consumer channel accounted for 12.9% of our total revenues in 2007.

Our Distribution Channels

We support tens of thousands of active users around the globe through our two primary distribution channels: the service provider channel and our direct-to-consumer channel. We market, support and distribute our products and services to customers in these channels.

Service Provider and Reseller Channel

We have developed and intend to continue to develop high-value solutions for the large number of service providers and resellers that are focused on providing their customers with VoIP telephony products and services. A description of our service provider and reseller offerings is provided below.

Hosted Consumer VoIP Solution. Our “Hosted Consumer VoIP Solution” (formerly known as our Outsourced Platform Solution) leverages our VoIP expertise and delivers to our service providers, resellers, and various corporate customers a highly customizable, private-label suite of VoIP products and services. Using our infrastructure, we enable these enterprises to offer their customers any combination of our basic products and services, accessible through a single account. We believe that our Hosted Consumer VoIP Solution brings our customers the value-added services they need to leverage their strong customer bases and generate new revenues. Our largest service provider customers demand a completely customized offering, and we have built our platforms in a manner that efficiently and effectively allows us to deploy a fully customized VoIP offering in a very short amount of time, and at significantly reduced cost when compared to the development of an in-house solution.

Our “Launch Ready” Hosted Consumer VoIP Solution is a turnkey VoIP solution specifically designed to provide our medium sized service provider customers with the ability to rapidly and efficiently deploy advanced VoIP services to their end customers. The “Launch Ready” solution enables us to deploy a full VoIP solution in a very compressed period of time while still allowing for the offering of a broad suite of services, features, and support services. We have successfully used this solution as the basis for several of our trials and transactions, and anticipate that it will continue to be the preferred platform for our smaller service provider customers.

In 2007, we continued to expand our target markets, and entered into an agreement with Market America, a leading on-line shopping and one-to-one marketing company, pursuant to which Market America launched its Voitel Home Phone Service powered by our Hosted Consumer VoIP Solution platform. In addition, we entered into an agreement with RCN Corporation, a leading provider of video, data, and voice services to residential, business, and commercial/carrier customers, to power its new Starpower Internet Phone Service. In 2006, our Hosted Consumer VoIP Solution was selected by ICQ Inc., the industry pioneer and a leader in instant messaging, as one of the service providers of its internet-based voice calling service offering. With this relationship, ICQ’s instant messaging customers throughout the world, outside of the United States, have access to VoIP services and features of deltathree (amongst others).

We intend to continue to add new offerings to our suite of VoIP products and services and strengthen our channels of distribution. As we take such actions, customers can realize new revenue streams from their existing customer base and make their own offering even more powerful and attractive. The products and services delivered under our Hosted Consumer VoIP Solution are supported at all times by our Network Operations Center and our customer care center.

Convergence of the Hosted Consumer VoIP Solution and the Reseller Program. For several years we have offered businesses the opportunity to become resellers of our services through our global reseller program. In the early years of the life of our Company, these resellers met their customers’ needs by purchasing account numbers in bulk at reseller specific rates, and they in turn resold these accounts to private individuals under the deltathree brand, their own brand, or as a white-label product. As our resellers became more sophisticated, we introduced new features and functions that allowed them to develop their own unique price plans and service bundles to more closely align their offerings with their own customers’ unique needs. In addition, we developed, and intend to continue to develop, increasingly sophisticated online toolsets to allow our resellers to better manage their internal processes and enable them to utilize our web-based customer care tools to provide customer service to their end-users through their own customer service team. Moreover, in order to attract and retain a variety of different resellers across the globe, we have continuously tested and certified for use with our VoIP services and network many different SIP devices manufactured by various vendors. We have certified many SIP devices that operate in different network environments, such as dial-up, broadband, cable, and satellite or Vsat. Based on these actions, we have increasingly set ourselves apart from our competitors by moving from an undifferentiated source of “telecom minutes” to a highly differentiated partner by providing these customers with a full suite of tools to manage and grow their business.

In doing so, the lines of differentiation between service providers and resellers continue to narrow as they grow increasingly similar. Both service providers and resellers are looking to leverage their unique own brands by selling sophisticated products and services to their own customers under their own brand, with their own look and feel. As such, our reseller customers are looking for advanced VoIP feature sets and applications to support their ability to deliver unique calling plans and bundled services to their end customers. Our customers’ desire for, and our ability to deliver, these increasingly sophisticated offerings supported by a variety of certified devices in different network environments is proving to be a critical competitive advantage in terms of growing sales with

existing customers, securing new customers, and converting customers from other vendor platforms. In order to continue to provide our reseller customers the best features and services available, we are constantly assessing our customer needs and deploying new enhanced services for the VoIP reseller market. During 2005 and 2006, we realized that our global reseller business was aligned with our Hosted Consumer VOIP Solution business because customers for both of these products and services already had access to the same features and functions. We, therefore, decided to combine these customer groups. We believe that this group will be more strategically aligned with the market and we expect to benefit from synergies from both of these customer bases.

Go2Call Acquisition. We strengthened our service provider and reseller channel and our direct-to-consumer channel and expanded our presence into new regions of the world with our acquisition of the service provider and consumer business assets, including the customer bases, of Go2Call. In connection with this asset transaction, which was completed in February 2007, we paid to Go2Call approximately \$7.0 million in a combination of cash and our stock and did not assume any liabilities other than the obligation to provide continued services to the acquired customer bases. Go2Call has been a leader in the VoIP industry and has delivered turnkey VoIP solutions to a variety of service providers, including telecom carriers, ISPs, broadband providers and licensed VoIP operators. Go2Call's customer base consisted of approximately 95% service providers and 5% consumers located in approximately 100 countries throughout the world and, therefore, this strengthened our own customer base in most of these countries. Due to Go2Call's geographical mix of customers, this acquisition has also brought us an increase in market penetration in certain key countries such as Brazil and Vietnam where we traditionally have not had a strong presence. Based on the similarity of offerings and customer bases and the complementary geographical mix, we were able to transition the Go2Call customers to our network in 2007.

Direct-to-Consumer Channel

Our direct-to-consumer channel includes our recently established joip offering, which serves as the exclusive VoIP service provider embedded in the Globalrange cordless phones of Panasonic (the world leader in consumer cordless phones) and our iConnectHere offering, which provides VoIP products and services directly to consumers and small businesses online. Prior to the recently launched joip offering, ICH was traditionally our direct-to-consumer channel. A description of these offerings is provided below.

joip: deltathree and Panasonic strategic alliance. We believe that with joip, our recently launched consumer brand, we have developed a unique, powerful, and innovative offering in both the VoIP and the cordless telephone markets. In connection with our strategic cooperation with Panasonic, which began in 2006, Panasonic and we have created, developed and are offering joip-enabled Panasonic Globalrange telephones. Our joip offering is the exclusive VoIP service embedded in Panasonic's Globalrange series of innovative hybrid two-line cordless phones, which provide both landline and VoIP services. Because our VoIP services are embedded in this hybrid cordless telephone, there is no requirement for any software downloads, external adaptors or other complicated procedures. The customers merely plug the phone into their broadband connection and are able to communicate. Additionally, customers of the Globalrange telephones are able to talk to each other for free through the use of the joip services, and are also able to purchase a variety of enhanced features and value-added services. Through our joip offering and extensive experience in VoIP services and Panasonic's consumer electronics expertise and vast distribution channels, Panasonic and we aim to create a global community by providing free calling between joip-enabled Globalrange phones in all regions of the world. We commenced the development and launch of this offering in August 2007. This phone is currently available in the United States, Canada, United Kingdom and Ireland, Germany, Spain and Austria.

We believe that this offering has many unique competitive advantages, such as:

- Dual functionality, in that it supports both VoIP services and traditional landline services;
- End users maintain their traditional landline service;
- Customers are able to speak to each other for free;
- Strong brand recognition, consumer electronic experience, and vast distribution channels of Panasonic;
- No set-up installation procedures, software downloads, external adaptors, or service contracts; and
- The joip-enabled phone can be purchased through the customary mass market distribution retailers and channels - providing for a traditional consumer purchase experience.

Due to the features, functionality, and purchase experience, we believe that this offering could have a significant impact in expanding VoIP technology from the early adaptor phase into the mass market phase.

iConnectHere. iConnectHere demonstrates our products, services and hosting capabilities to our reseller customers and service providers. Through iConnectHere, an account holder can access all of our product offerings, including PC-to-Phone and Broadband Phone. Additionally, iConnectHere permits us to collect usage information on our products and services and enables us to provide our service provider and reseller customers with key information and recommendations regarding implementation of our products and services.

Through iConnectHere, consumer users can:

- sign up for any of our services, including PC-to-Phone and Broadband Phone;
- download our software and/or order IP-based Broadband Phone devices;
- recharge their accounts, either by entering their credit card information or authorizing automatic recharging;
- send a PC-to-Phone call;
- check real-time billing and usage information;
- communicate by e-mail with a customer service representative; and
- view answers to frequently-asked questions.

Our Competitive Advantages

We believe we have several core competitive advantages that will allow us to maintain and expand our position as a leading provider of VoIP services.

Experience and Expertise in VoIP. We pioneered the development and deployment of commercially viable VoIP products and standards, and in doing so we have become a widely recognized provider of VoIP around the world. We have a proven track record of deploying robust, modular or comprehensive VoIP offerings to some of the most demanding large or mid-sized service providers, while successfully managing our VoIP services around the world and across a variety of networks and technologies. Over our twelve-year history, our engineering teams have consistently demonstrated their ability to develop and deploy innovative platforms (including what has become the dominant VoIP technology standard, SIP) while our research and development team has created inventive new products, feature enhancements and applications to improve the performance and quality of our services (including our innovative joip offering, which we have developed in connection with our strategic alliance with Panasonic). Our service provider and reseller solutions leverage the leading edge platform we developed for our own direct-to-consumer VoIP business and the lessons learned from first-hand experience in developing and deploying VoIP services around the world for more than a decade.

Scale. We deliver VoIP telephone services to tens of thousands of active, paying consumer and business users in over 100 countries through our direct-to-consumer channel, our service provider customers, and our global distribution network of approximately 400 resellers. As end-users around the world continue to look for alternative and improved telecommunications services, we can employ our products and services to a growing distribution network and capitalize on our existing relationships to partner with incumbent telecommunications providers, cable companies, ISPs, licensed VoIP operators, and various corporate enterprises. We expect to be well positioned to effectively and quickly deliver new products and services to large numbers of consumers through large and small service providers, resellers and our direct-to-consumer channel.

Strategic Relationships. We have established or expect to establish and expand our strategic relationships with large and mid-sized incumbent telecommunications providers, cable operators, ISPs, licensed VoIP operators, and various corporate enterprises. Through our innovative collaboration with Panasonic and our joip offering, we expect to develop a significant new market for our services and to have a significant impact in expanding VoIP technology from the early adaptor phase into the mass market phase. Through our relationships with companies such as Level 3 Communications and XO Communications, we are able to obtain access to high quality telecommunications services and networks at competitive prices, and also obtain access to such companies' existing and potential partners. We believe our VoIP telephony platform, combined with our strategic relationships with a variety of leading providers around the world, will enable us to continue to differentiate ourselves from other VoIP providers.

Our Strategy

Our strategy is to become a leading provider of VoIP telephony products and services, worldwide. The following are key elements of our strategy:

Capitalize on the Growth of the VoIP Marketplace. We believe we are well positioned to take advantage of the expected growth of the VoIP services and cable telephony markets. IDC, a market research firm, estimates that U.S. residential VoIP telephony subscribers will grow at a 60% compound annual growth rate from 4.3 million VoIP subscribers in 2005 to 44.0 million subscribers by the end of 2010.

Target Large to Mid-sized Telecom Providers. Our service provider and reseller channel will leverage its wins and experience to specifically target large to mid-sized incumbent telecom providers and various corporate enterprises in the U.S. and worldwide, as we believe these companies may be more likely to buy our services than to build their own VoIP services, as a viable alternative to more capital intensive and time consuming internal VoIP application development programs. We believe our service and our expertise in VoIP reduce these providers' costs, time to market and risks associated with developing and maintaining an in-house VoIP service.

Target Small to Mid-sized Cable Providers. Our service provider and reseller channel will leverage our demonstrated success in the deployment of sophisticated VoIP solutions, and target small to mid-sized cable operators in the U.S. and worldwide, whom we believe may be more likely to buy our services than the larger companies in the cable space. We believe that they will seek out the same incremental revenue opportunities as their larger peers, but may not have the significant technical and financial resources required to develop an internal cable telephony solution, such as the personnel to support network operations, engineering, support and project management, and may therefore instead embrace outsourcing as an effective manner to enter the marketplace. We believe our service and our expertise in VoIP reduces their costs, time to market and risks associated with developing and maintaining an in-house VoIP service.

Create Global Community with joip. Through our joip offering and extensive experience in VoIP services and Panasonic's leading consumer electronics expertise and vast distribution channels, Panasonic and we aim to create a global community by providing free calling between joip-enabled Globarange phones in all regions of the world. We are looking to leverage this strategic partnership to develop our direct-to-consumer channel and build value by up-selling a variety of enhanced features and value-added services to purchasers of these phones.

Offer Flexible and Modular Deployment Alternatives. We offer our service providers and resellers a choice of deployment alternatives ranging from full outsourcing to partial outsourcing through our modular offering suite. Depending on the particular needs of each of our customers, we design our offering to fit within their business objectives, available resources and desire level of participation. We can develop and integrate specific features and functions into our package, such as various network elements, access components, fulfillment, and the specific feature/functions the provider can offer to its end-users. For resource and capital constrained providers, we offer alternatives that require a lower amount of human resources, development time and financial investment by the customer.

Strategic Acquisitions and Alliances. In addition to our strategy and actions to grow organically as described above, we also actively evaluate and pursue appropriate acquisition targets and collaborations that will continue to expand and diversify our customer base. We analyze these initiatives to determine whether they are complimentary to our business and can provide synergies.

Sales and Marketing

We sell and market our products and services through our Service Provider and Reseller Channel and our Direct-to-Consumer Channel. We have a variety of customers throughout the world and, therefore, our sales and marketing strategy is customized to target each region, including specific local areas, in the world. In general, our sales and marketing activities include:

- selecting, training, and deploying regional sales managers to sell, market and maintain support for our customers and potential partners;
- attending, presenting, and participating at local industry trade venues;
- developing, deploying and supporting local-specific product features and services, such as multiple language capabilities, different currency capabilities, and various payment methods;
- pursuing strategic alliances with both customers, including licensed providers, and suppliers; and
- using various on-line advertising and search strategies to target and optimize sales efforts.

Service Provider and Reseller Channel

Service Provider Sales. We have developed and deployed a focused sales team that specifically targets large and medium incumbent telecom providers, mid-sized to smaller cable companies, ISPs and other broadband service providers, virtual network operators, licensed VoIP operators, and various corporate enterprises. This highly talented team markets to these customer targets around the world, focusing on developed and developing markets in the United States, Europe, Latin America and Asia. Our well-known success in deploying sophisticated solutions to the most demanding large telecom providers supplies us with significant leverage as we introduce these services to other service providers.

Reseller Program. Our Reseller sales force contracts with smaller service providers and resellers around the world, who in turn sell our products and services, under their own brand, a white-label brand and/or our deltathree brand to retailers, businesses, Internet cafés and others in their local markets. Our experience in providing differentiated VoIP solutions in the emerging international telecommunications environment enables us to effectively enter new markets as they open to competition. This group will continue to market to these resellers around the world, focusing on emerging markets in the Middle East, Asia and Central and South America.

Using our platform and solutions, resellers can quickly and easily sell our products to their own customers in their own specific markets.

Direct-to-Consumer Channel

joip: deltathree and Panasonic strategic alliance. We launched our joip service and Globalrange offering with Panasonic in August 2007. In this strategic alliance Panasonic will use its leading global experience and well-established product distribution channels to market and sell the product in each applicable local market. We will engage in a variety of targeted strategies through the use of on-line media, direct marketing and inbound telemarketing to market our joip offering. Panasonic and we, together, have begun to market the joip-enabled Globalrange phone to specific key channels.

iConnectHere. We have developed low-cost, diversified promotional programs to stimulate demand for our iConnectHere services. Our promotional programs include:

- **On-line “affiliate” agent commission program.** We have developed a Web-based agent program that allows for rapid agent enrollment and agent account maintenance. Agents may devise their own marketing programs, including Web-links, direct mail campaigns or co-branding of our services in select markets. Agents receive as commissions a percentage of revenue generated from end users who sign up for our services through the agent's website.
- **Off-line “affiliate” agent commission program.** Our off-line agent commission program allows non-Web agents to design their own marketing programs to solicit sales of our services. Off-line agents market and advertise through traditional channels such as newspaper and magazine advertisements, direct mail campaigns and telemarketing campaigns. Off-line agents receive a percentage of revenue generated from users who sign up for our services through the agent's programs.

Our Infrastructure

Network

In order to deliver leading VoIP products and services, we operate a privately-managed IP telephony network. By managing our network, we have the ability to regulate traffic volumes and to directly control the quality of service from each originating point of presence, or POP, to the termination point via a variety of termination options. Our ability to interconnect to a wide variety of termination options increases the diversity and robustness of our network, minimizes and eliminates single points of failure, and simultaneously allows us to benefit from pricing differences between vendors to the same termination points. In addition, our network allows us to avoid the significant transmission delays associated with the Internet, which may impede delivery of high quality, reliable services to our users.

In 2001, we rolled out our state of the art SIP infrastructure. The SIP protocol is one of the most advanced VoIP protocols and unlike its predecessors, which were modeled after traditional telephony protocols, SIP has the ability to scale with a distributed architecture and at a lower cost. SIP's superior attributes also include faster and more cost effective development and lower hardware requirements, which allows us to incur lower capital expenditure costs. Our SIP network currently powers the majority of our offerings.

Our network is built around a high availability backbone that connects New York, Los Angeles, Atlanta, London, Frankfurt and Hong Kong. In each of, and between, these locations we maintain multiple interconnections or peering arrangements with Internet backbone and voice providers. These points are strategically located to allow access from our network to and from the Internet with the best performance. While operating as a private extension of the Internet, our backbone has a high level of security designed to isolate it from security threats found on the public Internet.

Access to our network is possible through several products and services. A call can originate from the PC-to-Phone product using our downloadable software application “soft-phones,” a Web browser, or Broadband Phone devices. These calls enter our network from the Internet through our interconnection points. We carefully manage each originating point and use innovative capacity planning tools and techniques to provide the best and most cost effective service to customers.

Our network can terminate calls through our POPs and termination providers’ POPs. Termination decisions are based on a sophisticated least cost routing system which applies routing rules based on origination point, time of day, termination cost and other factors. These rules are constantly updated to ensure maximum economic and quality efficiency. Each termination port is carefully managed with innovative capacity planning tools and techniques to provide the best and most cost effective service to customers, along with multiple termination options to ensure the highest possible levels of redundancy.

We are party to service agreements with several telecommunications providers, including competitive local exchange carriers, foreign post, telephone and telegraph companies, Internet backbone providers and others. Pursuant to these agreements, we can transport VoIP packets to our hubs and terminate calls throughout the world in a cost effective and efficient manner.

Support

Our NOC monitors and manages our network from a central location, seven days a week, 24 hours a day. The NOC monitors all aspects of our network, including the routers, databases, switches, leased lines, Internet connections, gatekeepers and gateways, to ensure that they are functioning at optimal levels. In the event of a failure of any of these network components, NOC personnel are provided with a real time, systems-generated notification via an instant messaging system consisting of pagers, cellular phones, screen pop-ups and e-mail, which identifies the malfunction so that proper measures can be taken to restore service in a timely fashion. Our NOC utilizes a combination of proprietary and leading industry technologies as well as unique applications developed by us. The NOC serves all of the different parts of our operations environment, including network nodes, Web servers and specific applications.

We provide customer support on various levels to different customers. With respect to certain of our service provider and reseller customers, we provide customer care and technical support directly to these customers, and they in turn provide their own support directly to the end user. With some of our other service provider and reseller customers, we provide customer care and technical support, on behalf of the customer, directly to the end user. Customers of iConnectHere receive technical support and customer care through e-mail support.

Our services are supported by our on-line interactive customer service and billing center, which enables an end user to set up an account, receive an account number and a PIN, pay by credit card for services, find answers to frequently asked questions and contact customer service representatives. Once a user has established an account, the user can prepay for additional usage by credit card as well as access real-time detailed information such as call logs and transaction records. Through the on-line billing system, a user can personalize the billing information to select the data most relevant to them. This on-line interactive customer service and billing center is supported by a human customer care contact center that provides voice and e-mail support to the customers.

Suppliers

We outsource to third-party vendors the provisioning of certain of our local telecommunications services, including local phone numbers, access to the PSTN, operator assistance, directory listings and assistance, E-911 emergency services and local number portability. We also outsource the provisioning of our consumer premises equipment, such as our analog telephone adapters, IP Phones and gateways, and certain aspects of our customer care services. We do not rely on any one specific vendor for providing these services, except for E-911 emergency services and certain specific services of customer care. While we believe our relations with our suppliers are good, we believe that we could replace our suppliers if necessary and that although our ability to provide services to our customers may be impacted in such a case we do not expect that this would have a significantly adverse affect on our business, financial condition and results of operation.

Proprietary Rights

We rely and expect to be able to rely on trademark and trade secret laws, confidentiality agreements and other contractual arrangements with our employees, strategic partners and others to protect our proprietary rights.

We have registered trademarks, and have filed applications for additional registrations, for “deltathree®”, “iConnectHere.com®”, “joip®”, “joipy®”, “Click It®” and other trademarks in the United States and internationally. In connection with our acquisition of the Go2Call businesses, we acquired the “Go2Call®” trademark and a variety of trade-marked derivatives of “Go2Call®”. However, these trademarks may not provide adequate protection against competitive technology and may not be held valid and enforceable if challenged. We do not own any registered copyrights.

To further safeguard our intellectual property, we have a policy that requires our employees to execute confidentiality and technology ownership agreements when they begin their relationships with us.

Regulation

Regulatory Environment Overview

The use of the Internet and private IP networks to provide voice service is a relatively recent market development. Although the provision of such services is currently not as regulated as traditional telephony services within the United States, the Federal Communications Commission, or FCC, has applied some regulation to certain types of VoIP services and is reviewing whether to apply additional regulations to VoIP services. The United States Congress is also considering whether to impose new and additional regulations on providers of VoIP services, including us. In addition, several foreign governments have adopted or proposed regulations that could be interpreted to restrict or prohibit the provision of VoIP services. Other countries, however, have begun to open their markets to competition from new Internet-based voice services. Regulation of Internet telephony providers and services may materially and adversely affect our business, financial condition, operating results and future prospects, particularly if increased numbers of governments impose regulations restricting the use and sale of IP telephony services.

Federal Regulation

Regulatory Classification of VoIP Services

To date, the FCC has not imposed traditional common carrier regulation upon providers of Internet communications services, but it has begun regulating this area on a limited basis as outlined in this section. On February 12, 2004, the FCC initiated a generic rulemaking proceeding concerning the provision of voice and other services using IP technology, including assessing whether VoIP services should be classified as information services or telecommunications services. In November 2004, the FCC determined that VoIP services with certain characteristics are interstate services subject to federal rather than state jurisdiction. We believe that some of the VoIP services that we provide constitute information services, while others are classified as "interconnected VoIP services," which are discussed more below. The FCC's generic rulemaking proceeding, however, could result in the FCC determining, for instance, that certain types of Internet telephony should be regulated like basic telecommunications services. Thus, Internet telephony could no longer be exempt from access charges, which reimburse local carriers for use of their local telephone network, telecommunications related regulatory obligations, or other economic regulations typically imposed on traditional telecommunications carriers.

The imposition of access charges and other types of regulatory fees and charges or the costs of complying with certain regulations could substantially increase our costs of serving our customers in the U.S. We may have to increase our prices to cover these costs, which could have a negative impact on our ability to compete with other telephony providers. The imposition of certain regulations might also negatively affect the incentives for companies to continue to develop IP technologies to offer VoIP services because companies may need to divert resources from research and development to comply with regulatory requirements. It is also possible that the FCC might adopt a regulatory framework that is unique to IP telephony providers or one where IP telephony providers are subject to reduced regulatory requirements, which we believe would be good for us. We cannot predict what additional regulations, or the extent of such regulation, if any, the FCC may impose. We cannot predict when the FCC will issue a final decision regarding the regulatory classification of VoIP services, the outcome of the decision, or the result of any subsequent proceedings or actions that may arise out of the FCC's decision. As a result, we cannot assure you that some or all of our products and services will not be more heavily regulated in the future.

VoIP E-911 Matters

On June 3, 2005, the FCC released an order and notice of proposed rulemaking concerning VoIP emergency 911 services. The order set forth two primary requirements for providers of "interconnected VoIP services", meaning VoIP services that can be used to send and receive calls to or from users on the PSTN. The order applies to our iConnectHere customers. We do not believe that we are responsible for compliance with this order in connection with the services sold to our customers who purchase our services for the provision of services directly to end users. Clarification of this issue has been raised by similar providers with the FCC, however, the FCC has not addressed it to date and we cannot predict how the FCC would rule on this issue. Furthermore, depending on the FCC's ruling on this issue, we cannot predict whether we would be subject to any third-party litigation in connection with such customers who resell our services.

First, the order required us to notify our iConnectHere customers of the differences between the emergency services available through us and those available through traditional telephony providers. We also had to receive affirmative acknowledgment from all of our iConnectHere customers that they understand the nature of the emergency services available through our service. On September 27, 2005, the FCC's Enforcement Bureau released an order stating that the Enforcement Bureau will not pursue enforcement actions against VoIP providers, like us, that have received affirmative acknowledgement from at least 90% of their subscribers. We are required to file a report with the FCC when we receive affirmative acknowledgments from 100% of our customer base. We have received affirmative acknowledgment from more than 95% of our iConnectHere customers that they understand the nature of the emergency services available through our service, and thus we are substantially in compliance with the first aspect of the FCC's June 3 order.

Second, the order required us to provide enhanced emergency dialing capabilities, or E-911, to all of our iConnectHere customers by November 28, 2005. Under the terms of the order, we are required to use the dedicated wireline E-911 network to transmit customers' 911 calls, callback number and customer-provided location information to the emergency authority serving the customer's specified location. On November 7, 2005, the FCC's Enforcement Bureau issued a Public Notice with respect to that requirement. The Public Notice indicated that providers who have not fully complied with the enhanced emergency dialing capabilities requirement are not required to discontinue the provision of services to existing clients, but that the FCC expects that such providers will discontinue marketing their services and accepting new customers in areas in which the providers cannot offer enhanced emergency dialing capabilities.

We also have taken many significant steps to comply with the enhanced emergency service rules, but we were unable to comply with all of the requirements of the FCC's order by the November 28, 2005 deadline. Almost all of our iConnectHere customers currently receive E-911 service in conformity with the FCC's order, but some may not receive such service. These are customers who were receiving service prior to the FCC's deadline for compliance with the E-911 regulations. The FCC permitted service providers to continue to provide service to those existing customers rather than disconnect those customers. Pursuant to the FCC's requirement, after the implementation of the FCC E-911 requirements, we provide services to customers only where we can provide the FCC required E-911 service. We may be required to stop serving those iConnectHere customers to whom we cannot provide the required enhanced emergency dialing capabilities that were being serviced prior to the issuance of the FCC's rules at any time, but this is difficult to predict at this time.

The FCC's June 3, 2005 order also included a notice of proposed rulemaking that considers, among other things, whether interconnected VoIP providers must transition to an emergency services system that would enable interconnected VoIP providers to establish the location of their customers without the customer providing location information. The comment period closed September 12, 2005. We do not know when the FCC may take further action in this proceeding. If the FCC adopts additional regulatory obligations, implementing systems to comply with the obligations could be time consuming and expensive.

See "—Fees and Taxes" for a discussion of fees we may collect in the future in connection with providing E-911.

Bundling of DSL and Voice Services by Incumbent Telephone Companies

In March 2005, the FCC ruled that state public utility commissions cannot require that incumbent telecommunications carriers permit competing carriers to provide voice service to retail customers over the same copper wires used by the incumbent carriers to provide DSL service. As a result of this ruling, many incumbent carriers no longer permit retail customers to purchase DSL as a stand-alone service. This ruling makes our service much less attractive to customers who obtain broadband Internet access through an incumbent telecommunications carrier because the incumbent carrier can require them to buy voice service together with DSL. While some incumbent carriers make DSL available on a stand-alone basis, they have no legal obligation to do so and could discontinue such offerings at any time. However, in connection with its approval on October 31, 2005, of the mergers of SBC and AT&T and Verizon and MCI, the FCC required each of the merged companies to offer DSL service for two years from the implementation of stand-alone DSL service, but no more than three years from the date of the FCC's merger orders. The two combined companies also agreed to offer "naked DSL" services for a period of thirty months from the effective dates of the mergers as a condition for approval of their respective mergers. These conditions could make our service more attractive to our customers who obtain broadband Internet access through the merged entities. In addition to the FCC's requirements, some states imposed conditions on their approvals of the mergers that require the merged companies to offer stand-alone DSL.

Communications Assistance for Law Enforcement Act

The Communications Assistance for Law Enforcement Act, or CALEA, requires certain communications service providers to assist law enforcement agencies in conducting lawfully authorized electronic surveillance. On September 23, 2005, the FCC released an order concluding that CALEA applies to interconnected VoIP providers. The FCC established a deadline of May 14, 2007, for VoIP providers to comply with the requirements of CALEA. In May 2006 the FCC released an order finding that broadband Internet access service providers and interconnected VoIP providers are required to implement the same type of CALEA requirements that have been applied to wireline telecommunications carriers. These include obligations to (1) ensure that communications equipment, facilities, and services meet interception assistance capability requirements and (2) develop system security policies and procedures to define employee supervision and record retention requirements. The FCC determined that interconnected VoIP providers may rely on standards developed by industry standards-setting bodies as a "safe harbor" for CALEA implementation and may use trusted third parties as a reasonable method of achieving CALEA compliance. In either case, however, the interconnected VoIP provider remains responsible for compliance with the CALEA requirements. As a result of the steps we have taken, we believe that we comply with the CALEA.

Universal Service Fund

The FCC decided in June 2006 that interconnected VoIP service providers should be required to contribute to the universal service fund, or USF, on an interim basis. The amount of universal service contribution for interconnected VoIP service providers is based on a percentage of revenues earned from end-user interstate services. The FCC developed three alternatives under which an interconnected VoIP service provider may elect to calculate its universal service contribution: (1) an interim safe harbor that assumes 64.9% of the provider's end user revenues are interstate; (2) a traffic study to determine an allocation for interstate end user revenues; or (3) actual interstate and international end user revenues. If an interconnected VoIP service provider calculates its universal service contributions based on its actual percentage of interstate calls, the interstate classification of the service might no longer apply, in which case the interconnected VoIP service provider could be subject to regulation by each state in which it operates as well as federal regulation. In addition, the FCC is considering a number of proposals that could alter the way that the USF is assessed. For instance, the FCC is considering an assessment based on the use of telephone numbers. The FCC also is considering whether to apply universal service requirements to interconnected VoIP service providers on a permanent basis, and how contributions should be assessed in the future. Further, some states are looking at whether VoIP services should be subject to state universal service contribution requirements. We cannot predict how the courts, the FCC, and states may rule on these matters. Any changes to the assessment and recovery rules for universal service may affect our financial results.

Customer Proprietary Network Information

On April 2, 2007, the FCC issued an order that tightened existing rules on protection and use of Customer Proprietary Network Information, or CPNI, and extended coverage of the CPNI rules to interconnected VoIP service providers (such as the Company). Although the rules are aimed in large part at preventing the practice of pretexting (in which a caller impersonates a phone customer to gain access to his or her phone records), the rules impose greater obligations on us and other companies like us to protect customer calling and network information and to file formal certifications with the FCC regarding procedures for protecting this information. Failure to comply is subject to FCC enforcement. The new rules went into effect on December 8, 2007. We do not expect these rules, or our ability to comply with them, to have a material adverse effect on our operations, financial position or results of operations.

Intercarrier Compensation

The FCC is currently seeking comment concerning proposed reforms of the intercarrier compensation system, which is a set of FCC rules and regulations by which telecommunications carriers compensate each other for the use of their respective networks. These rules and regulations affect the prices we pay to our suppliers for access to the facilities and services that they provide to us, such as termination of calls by our customers onto the public switched telephone network. In addition, proceedings have been initiated to determine what intercarrier compensation charges should apply to the termination of VoIP traffic. We cannot predict what, if any, intercarrier compensation regulations the FCC's order may impose on VoIP providers.

Other FCC Proceedings That Could Affect VoIP Services

There are several other recent or ongoing FCC proceedings initiated by various persons that relate to VoIP and other Internet services. Certain of the FCC's conclusions in these proceedings could have an effect on the VoIP industry generally and on our business.

State Regulation

Despite the FCC's actions and FCC rulings to the contrary, some state regulatory authorities believe they retain jurisdiction to regulate the provision of, and impose charges on, intrastate Internet and VoIP telephony services. 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.

Fees and Taxes

There are numerous fees and taxes assessed on traditional telephone services that we believe have not been applicable to us and that we have not paid in the past. However, we may begin to collect and remit some of these fees and taxes in the future. To the extent we increase 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 we may have.

Calls to 911 are answered by public safety agencies supported by state and local taxes and fees on traditional telephone companies. In the future, we may be required to pay such fees to state and other authorities in connection with E-911. The FCC has mandated that we provide E-911 services, but refrained from ordering interconnected VoIP service providers from contributing to state funds. It is reviewing the issue as part of its Further Notice of Proposed Rulemaking concerning E-911 issues. A handful of states have addressed how VoIP providers should contribute to support public safety agencies and in these states we may be required to remit fees to the appropriate state agencies.

In addition, it is possible that we will be required to collect and remit sales and excise taxes in several states where we have not done so in the past. We are in the process of discussing the applicability of sales and other taxes with numerous states and we may proactively enter into discussions with additional states as conditions warrant. If we determine that we need to collect and remit sales and excise taxes, we will comply with the administrative rules existing in that state.

States have or may take the position that we should have collected sales and excise taxes in the past. If so, they may seek to collect those past taxes from us and impose fines, penalties or interest charges on us. Our payment of these past taxes and related charges could have a material adverse effect on us.

In addition to sales and excise taxes, there are various state, municipal and local taxes and fees that are applicable to traditional telephone companies that we believe are not and should not be applicable to us. If, contrary to our belief, we are or become subject to these taxes or fees, we will be required to pay or collect and remit them, which would erode our price advantage when we compete for customers. In addition, we could be required to pay these taxes or fees, and related charges, retroactively. Our payment of these past taxes and fines, penalties or interest charges could have a material adverse effect on us.

International

The regulatory treatment of Internet and Internet-based voice services, including IP telephony or VoIP, outside of the United States varies widely from country to country. A number of countries may prohibit Internet and IP telephony, while other countries expressly permit but regulate Internet and IP telephony. Some countries evaluate proposed Internet and IP telephony service on a case-by-case basis to determine whether any regulation is necessary or whether it should be regulated as a voice service or as another telecommunications or data service. Finally, in many countries neither Internet nor IP telephony have been addressed by legislation or regulatory action as of the date of this filing. Although we strive to comply with applicable international IP telephony regulations, we cannot be certain that we are in compliance with all of the relevant regulations at any given point in time.

In 2002, the European Commission adopted a set of directives for a new framework (New Regulatory Framework) for electronic communications regulation that, in part, attempts to harmonize the regulations that apply to services regardless of the technology used by the provider. Under the New Regulatory Framework, there is no distinction in regulation made based upon technology between switched or packet-based networks. As a result of this technology neutral regulatory approach, some types of IP telephony and VoIP services may be regulated like traditional telephony services while others may remain free from regulation. The European Commission has published a staff working paper aimed at clarifying the conditions applicable to providers of IP-based services. The working paper identifies various issues that may arise in relation to IP-based services including the regulatory classification of Internet telephony and VoIP under the New Regulatory Framework. The European Regulators Group (consisting of regulators from European Union Member States and the European Commission) has adopted a Common Statement for VoIP regulation. The European Commission currently is reviewing how IP telephony services fit into the New Regulatory Framework. Although the European Commission has recommended that a "light touch" to regulation be taken, we cannot predict what future actions the European Commission, member states, and courts reviewing the New Regulatory Framework may take regarding IP telephony and related matters, or what impact, if any, such actions may have on our business.

Based on the European Commission's current position, we believe that most providers of IP telephony would be subjected to no more than minimal regulation such as a general authorizations or declaration requirements that may be imposed by the European Union Member States, subject to the European Commission's current review of the issue. Several Member States have issued statements or regulations concerning IP telephony and VoIP while others have issued consultations requesting industry comments on the applicability of the New Regulatory Framework to various IP telephony and VoIP services in their respective countries. However, since the Commission's findings on IP telephony are not binding on the Member States, we cannot assure you that the services provided over our network will not be deemed "voice telephony" subject to heightened regulation by one or more EU Member States. For example, the United Kingdom has opened a proceeding to review the regulation of Internet-based voice services. Although Member States are required to adhere to the New Regulatory Framework, Member States may not take a uniform approach in regulating a particular Internet-enabled service including IP telephony. We cannot predict the outcome of these consultations or the manner in which Member States will implement the New Regulatory Framework with respect to our particular services.

As we make our services (particularly joip) available in foreign countries, and as we facilitate sales by our network partners to end users located in foreign countries, such countries may claim that we are required to qualify to do business in the particular foreign country. Such countries may also claim that we are subject to regulation, including requirements to obtain authorization for the provision of voice telephony or other telecommunications services, or for the operation of telecommunications networks. Indeed, in connection with the launch of our joip service, we have registered to provide the service in various foreign countries and expect that we will be required to register in additional foreign countries in the future. It is also possible that such countries may claim that we are prohibited in all cases from providing our services or conducting our business in those countries. Failure to qualify as a foreign corporation in certain jurisdictions, or to comply with foreign laws and regulations, may adversely affect our business. In addition, we cannot predict how a regulatory or policy change of a particular country might affect the provision of our services.

Our network partners may also currently be, or in the future may become, subject to requirements to qualify to do business in a particular foreign country, comply with regulations (including requirements to obtain authorizations for the provision of voice telephony or other telecommunications services or for the operation of telecommunications networks) or cease providing services or conducting their business as conducted in that country. We cannot be certain that our network partners either are currently in compliance with any such requirements, will be able to comply with any such requirements, and/or will continue in compliance with any such requirements.

Other Regulation Affecting the Internet

The European Union has also enacted several directives relating to the Internet, including regulations that address online commerce and data protection. International governments are adopting and implementing privacy and data protection regulations that establish certain requirements with respect to, among other things, the confidentiality, processing and retention of personal subscriber information. The potential effect, if any, of these data protection rules on the development of our business remains uncertain.

Competition

We compete primarily in the market for enhanced VoIP telephony. This market is highly competitive and there are numerous competing service providers. We believe that the primary competitive factors determining our success in the VoIP telephony market are: quality of service and network capacity; the ability to meet and anticipate customer needs through multiple service offerings and feature sets; customer services; and price.

Future competition could come from a variety of companies both in the Internet and telecommunications industries. These industries include major companies who have greater resources and larger subscriber bases than we have, and have been in operation for many years. We also compete in the growing market of discount telecommunications services including “pure play” VoIP service providers, calling cards, prepaid cards, call-back services, dial-around or 10-10 calling and collect calling services. In addition, some Internet service providers have begun to aggressively enhance their real time interactive communications, including instant messaging, PC-to-PC and PC-to-Phone services, and Broadband phone services.

IP Telephony Providers. Many companies provide, or are planning to provide, certain portions of the complete communications solution we offer, including Net2Phone, Vonage, and MediaRing.

Traditional Telecommunications Carriers and Broadband Services Providers. Several traditional telecommunications companies, such as AT&T, Sprint, Deutsche Telekom, and Qwest Communications International, and established broadband services providers, such as Time Warner, Comcast, and Cablevision, have announced VoIP telephony services and products and/or their intention to offer such products and services in both the United States and internationally. All of these competitors are significantly larger than we are and have:

- substantially greater financial, technical and marketing resources;
- larger networks;
- a broader portfolio of services;
- stronger name recognition and customer loyalty;
- well-established relationships with many of our target customers; and
- an existing user base to which they can cross-sell their services.

These and other competitors may be able to bundle services and products that are not offered by us together with VoIP telephony services, which could place us at a significant competitive disadvantage. Many of our competitors enjoy economies of scale that can result in lower cost structure for transmission and related costs, which could cause significant pricing pressures within the industry. At the same time, we see these potential competitors as potential customers, and have organized our various service provider and reseller products and services to meet the emergent needs of these companies.

Revenues and Assets by Geographic Area

For the year ended December 31, 2007, approximately \$16.8 million, or 56.9%, of our revenue was derived from international customers, and \$12.7 million, or 43.1%, was derived from customers in the United States. Most of our long-lived assets are located in the United States. For more detailed information concerning our geographic segments, see Note 13 to our financial statements included elsewhere in this Annual Report.

Employees

As of December 31, 2007, we employed 128 full-time and 20 part-time employees, of which 124 were located in Israel and 24 were located in New York. We consider our relationship with our employees to be good. None of our employees is covered by collective bargaining agreements.

Available Information

Our Internet address is www.deltathree.com. Through a link at the Investor Relations section of our website located at www.deltathree.com, we make available, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such materials have been electronically filed with, or furnished to, the Securities and Exchange Commission, or SEC.

ITEM 1A. RISK FACTORS

Our business, financial condition and results of operations and the trading price of our common stock could be materially adversely affected by any of the following risks as well as the other risks highlighted elsewhere in this Annual Report, particularly the discussions about regulation, competition and intellectual property. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

Risks Related to our Company

We have a history of losses and we are uncertain as to our future profitability.

Except for the year ended December 31, 2006, in which the Company reported net income of approximately \$500,000 but a net loss from operations of \$52,000, the Company has had a history of significant losses since its inception, and we may continue to incur significant losses for the foreseeable future. We reported net losses of \$9.3 million in 2007 and \$0.9 million in 2005. As of December 31, 2007, our accumulated deficit was approximately \$161.0 million. Our revenues may not grow or even continue at their current level. Going forward, we will need to increase our revenues and lower our current cost structure to obtain profitability. If our revenues do not increase and/or if we are unable to reduce our expenses, we may not be able to reach profitability again. We cannot assure you that we will be able to obtain profitability on a quarterly or annual basis in the future.

We may not be able to expand our revenue.

Our business strategy is to expand our revenue sources and our distribution channels in order to include the provision of VoIP telephony to different customer groups. We can neither assure you that we will be able to accomplish this nor that this strategy will be profitable. Currently, our revenues are primarily generated by sales of our VoIP telephony products and services through our direct-to-consumer channel and our service provider and reseller sales channel (including sales of our Hosted Consumer VoIP Solution). VoIP telephony from these channels generated 98.3%, 94.6% and 96.1% of our total revenues in 2007, 2006 and 2005, respectively.

In the future, we intend to generate increased revenues in VoIP telephony, from multiple sources and customer bases, many of which are unproven. We expect that our revenues for the foreseeable future will be dependent on, among other factors:

- sales of our VoIP telephony products and services, including sales of our Hosted Consumer VoIP Solution;
- acceptance and use of VoIP telephony;
- expansion of our service and product offerings;
- traffic levels on our network;
- the effect of competition, regulatory environment, international long distance rates and access and transmission costs on our prices; and
- continued improvement of our global network quality.

We may not be able to sustain our current revenues or successfully generate additional revenues from the sale of VoIP telephony, including our Hosted Consumer VoIP Solution.

Decreasing telecommunications prices may cause us to lower our prices to remain competitive, which could prevent our future profitability.

Decreasing telecommunications prices may diminish or eliminate the competitive pricing advantage of our services. International and domestic telecommunications prices have decreased significantly over the last few years in most of the markets in which we operate, and we anticipate that prices will continue to be reduced in all of the markets in which we do business or expect to do business. Users who select our services (or our resellers' or our Hosted Consumer VoIP customers' services) to take advantage of the current pricing differential between traditional telecommunications prices and our (or our customers') prices may switch to traditional telecommunications carriers as such pricing differentials diminish or disappear, and we will be unable to use such pricing differentials to attract new customers in the future. Such competition or continued price decreases may require us to lower our prices to remain competitive, may result in reduced revenue, a loss or decrease of customers and may prevent our future profitability.

We have a limited operating history upon which you can evaluate us.

Although we commenced our operations in 1996, in 2000 we began to transform our business from a provider of wholesale minutes to carriers to our current role as a provider of VoIP solutions. We, therefore, have only a limited operating history upon which you can evaluate our current business and prospects. You should consider our prospects in light of the risks, expenses and difficulties we may encounter as an early stage company in the new and rapidly evolving market for VoIP telephony. These risks include our ability:

- to increase acceptance of our VoIP telephony products and services (including our Hosted Consumer VoIP Solution);
- to compete effectively;
- to identify and enter into strategic alliances; and
- to develop new products and keep pace with developing technology.

In addition, because we expect an increasing percentage of our revenues to be derived from our VoIP telephony products and services (including our Hosted Consumer VoIP Solution), our past operating results may not be indicative of our future results.

We may need additional capital to finance our operations and grow our business.

Due to the nature of our industry, our future capital needs are difficult to predict. Therefore, we may require additional capital to fund some or all of the following:

- □ introduction and deployment of our new, or existing, products and services, including our joip offering;
- □ enhancement and expansion of our network;
- □ unanticipated opportunities;
- □ strategic alliances, and potential acquisitions;
- □ changing business conditions; and
- □ unanticipated competitive pressures.

While we believe we have sufficient funds to meet our working capital requirements for at least the next fiscal year, if our cash flow from operations is not sufficient to meet our capital expenditure and working capital requirements we will need to raise additional capital. There can be no assurance that we will be able to raise such additional capital on favorable terms or at all. If we will not have sufficient funds to meet our working capital requirements and are unable to obtain additional capital we will be required to reduce the scope of our business, which could have a material adverse effect on our business, financial condition, and results of operations.

Our acquisition activity could disrupt our ongoing business and may present risks not contemplated at the time of the transactions.

We recently acquired the service provider and consumer businesses of Go2Call and we may continue to acquire companies, businesses, products and technologies that complement our strategic direction. These acquisitions may involve significant risks and uncertainties, including:

- □ inability to successfully integrate the acquired technology and operations into our business and maintain uniform standards, controls, policies, and procedures;
- □ distraction of management's attention away from normal business operations;
- □ challenges retaining the key employees of the acquired operation;
- □ insufficient revenue generation to offset liabilities assumed;
- □ expenses associated with the acquisition; and
- □ unidentified issues not discovered in our due diligence process, including product quality issues and legal contingencies.

Acquisitions are inherently risky. We can not be certain that our previous or future acquisitions will be successful and will not materially adversely affect the conduct, operating results or financial condition of our business. We paid approximately 60% of the purchase price for our Go2Call acquisition with shares of our common stock. If we continue to issue common stock or other equity-related purchase rights as consideration in future acquisitions, current shareholders' percentage ownership and earnings per share may become diluted.

The success of our VoIP telephony products and services is dependent on the growth and public acceptance of VoIP telephony.

The success of our VoIP telephony products and services is dependent upon future demand for VoIP telephony systems and services. In order for the VoIP telephony market to continue to grow, several things need to occur. Telephone and cable service providers must continue to invest in the deployment of high speed broadband networks to residential and business customers. VoIP networks must improve quality of service for real-time communications, managing effects such as packet jitter, packet loss, and unreliable bandwidth, so that toll-quality service can be provided. VoIP telephony equipment and services must achieve a similar level of reliability that users of the public switched telephone network have come to expect from their telephone service. VoIP telephony service providers must offer cost and feature benefits to their customers that are sufficient to cause the customers to switch away from traditional telephony service providers. Service providers and resellers must be willing to use outsourced solutions providers for VoIP telephony. Furthermore, end users in markets serviced by recently deregulated telecommunications providers are not familiar with obtaining services from competitors of these providers and may be reluctant to use new providers, such as us. We will need to devote substantial resources to educate customers and end users about the benefits of VoIP telephony solutions in general and our services in particular. For example, although we believe that our joip offering embedded in Panasonic's Globarange cordless telephone may be an easy way to introduce and educate end users about VoIP telephony, we cannot assure you that consumers will purchase this offering or that they will use the VoIP features of this phone. If any or all of these factors fail to occur, our business may decline.

Our future success depends on the growth in the use of the internet as a means of communications.

If the market for VoIP telephony, in general, and our services in particular, does not grow at the rate we anticipate or at all, we will not be able to increase our number of users or generate revenues we anticipate. To be successful, VoIP telephony requires validation as an effective, quality means of communication and as a viable alternative to traditional telephone service. Demand and market acceptance for recently introduced services are subject to a high level of uncertainty. The Internet may not prove to be a viable alternative to traditional telephone service for reasons including:

- inconsistent quality or speed of service, including power outages;
- traffic congestion on the Internet;
- potentially inadequate development of the necessary infrastructure;
- lack of acceptable security technologies;
- lack of timely development and commercialization of performance improvements; and
- unavailability of cost-effective, high-speed access to the Internet.

If Internet usage grows, the Internet infrastructure may not be able to support the demands placed on it by such growth, or its performance or reliability may decline. In addition, websites may from time to time experience interruptions in their service as a result of power outages and other delays occurring throughout the Internet network infrastructure. If these outages or delays occur frequently, customers' use of the Internet and our products and services as a means of communications could decline or may not grow as we anticipate.

Intense competition could reduce our market share and decrease our revenue.

The market for VoIP telephony is extremely competitive. Our competitors include both start-up IP telephony service providers and established traditional communications providers. Many of our existing competitors and potential competitors have broader portfolios of services, greater financial, management and operational resources, greater brand-name recognition, larger subscriber bases and more experience than we have. In addition, many of our IP telephony competitors use the Internet instead of a private network to transmit traffic. Operating and capital costs of these providers may be less than ours, potentially giving them a competitive advantage over us in terms of pricing.

We also compete in the growing market of discount telecommunications services including calling cards, prepaid cards, call-back services, dial-around or 10-10 calling and collect calling services. In addition, some Internet service providers have begun to aggressively enhance their real time interactive communications, focusing on instant messaging, PC-to-PC and PC-to-phone, and/or broadband phone services.

In addition, traditional carriers, cable companies and satellite television providers are bundling services and products that we do not offer together with internet telephony services. These services could include wireless communications, voice and data services, Internet access, and cable television. Although this provides us with the opportunity to offer these companies our products and services as a way for them to offer internet telephony services, these companies can also introduce these services on their own and may be able to bundle the services at a single attractive price. This could make it more difficult for us to compete against them with direct to consumer offerings of our own.

If we are unable to provide competitive service offerings, we may lose existing customers and be unable to attract additional customers. In addition, many of our competitors, especially traditional carriers, enjoy economies of scale that result in a lower cost structure for transmission and related costs, which cause significant pricing pressures within the industry. To remain competitive, we must continue to invest significant resources in research and development, sales and marketing, and customer support. We may not have sufficient resources to make these investments or to make the technical advances necessary to be competitive which, in turn, will cause our business to suffer.

Potential fluctuations in our quarterly financial results may make it difficult for investors to predict our future performance.

Our quarterly operating results may fluctuate significantly in the future as a result of a variety of factors, many of which are outside our control. The factors generally within our control include:

- the rate at which we are able to attract users to purchase our VoIP telephony products and services, including our Hosted Consumer VoIP Solution;
- the amount and timing of expenses to enhance marketing and promotion efforts and to expand our infrastructure; and
- the timing of announcements or introductions of new or enhanced services by us.

The factors outside our control include:

- the timing of announcements or introductions of new or enhanced services by our competitors;
- regulations in various countries that prohibit us from providing our services cost-effectively or at all;
- technical difficulties or network interruptions in the Internet or our privately-managed network; and
- general economic and competitive conditions specific to our industry.

The foregoing factors also may create other risks affecting our long-term success, as discussed in the other risk factors.

We believe that quarter-to-quarter comparisons of our historical operating results may not be a good indication of our future performance, nor would our operating results for any particular quarter be indicative of our future operating results.

Our success depends on our ability to handle a large number of simultaneous calls, which our network may not be able to accommodate.

We expect the volume of simultaneous calls to increase significantly as we expand our operations. Our network hardware and software may not be able to accommodate this additional volume. If we fail to maintain an appropriate level of operating performance, or if our service is disrupted, our reputation could be hurt, we could lose customers and our business, financial condition and results of operations could be materially and adversely affected.

We face a risk of failure of computer and communications systems used in our business.

Our business depends on the efficient and uninterrupted operation of our computer and communications systems as well as those that connect to our network. We maintain communications systems in facilities in New York, Los Angeles, Atlanta, London, Frankfurt and Hong Kong.. Although we have designed our network to reduce the possibility of disruptions or other outages, our systems and those that connect to our network are subject to damage or interruption from natural disasters, power loss, communications failure, hardware or software malfunction, network failures, physical or electronic break-ins, sabotage, computer viruses, intentional acts of terrorism or vandalism and other events that may be or may not be beyond our control. Any system interruptions that cause our services to be unavailable, including significant or lengthy telephone network failures or difficulties for users in communicating through our network or portal, could damage our reputation and result in a loss of users.

Substantially all of the VoIP telephony calls made by our iConnectHere customers and a large percentage of our service providers and reseller customers are connected through local telephone companies and, at least in part, through leased facilities that may become unavailable.

We are not a local telephone company or a local exchange carrier. Our network covers only portions of the United States. Accordingly, we must route parts of some domestic and all international calls made by our ICH customers, and a large percentage of our service provider and reseller customers, over leased transmission facilities. In addition, because our network does not extend to homes or businesses, we must generally route calls through a local telephone company to reach our network and, ultimately, to reach their final destinations.

In many of the foreign jurisdictions in which we conduct or plan to conduct business, the primary provider of significant in-country transmission facilities is the national telephone company, which may be the only provider in that country. Accordingly, we may have to lease transmission capacity at artificially high rates from such a monopolistic provider, and consequently, we may not be able to generate a profit on those calls. In addition, national telephone companies may not be required by law to lease necessary transmission lines to us or, if applicable law requires national telephone companies to lease transmission facilities to us, we may encounter delays in negotiating leases and interconnection agreements and commencing operations. Additionally, disputes may result with respect to pricing, billing or other terms of these agreements, and these disputes could affect our ability to continue to operate in these countries, which may materially and adversely affect our business, financial condition and results of operations.

Our computer systems and operations may be vulnerable to security breaches.

We believe that the secure transmission of confidential information over the Internet, such as credit card numbers, is essential in maintaining user confidence in our services. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, our computer infrastructure is potentially vulnerable to physical or electronic computer viruses, break-ins and similar disruptive problems and security breaches that could cause interruptions, delays or loss of services to our users. We rely on licensed encryption and authentication technology to effect secure transmission of confidential information, including credit card numbers. It is possible that advances in computer capabilities or new technologies could result in a compromise or breach of the technology we use to protect user transaction data. A party that is able to circumvent our security systems could misappropriate proprietary information or cause interruptions in our operations. Security breaches also could damage our reputation and expose us to a risk of loss, litigation and possible liability. Although we have experienced no security breaches to date of which we are aware, we cannot guarantee you that our security measures will prevent security breaches.

Operating internationally exposes us to additional and unpredictable risks.

We intend to continue to enter additional foreign markets and expand our existing operations outside the United States. We cannot assure you that we will be successful in expanding into additional international markets. In addition to the uncertainty regarding our ability to generate revenue from foreign operations and expand our international presence, there are certain risks inherent in doing business on an international basis, including:

- □ political and economic instability;
- □ legal uncertainty regarding liability, regulations, tariffs and other trade barriers;
- □ fluctuations in exchange rates;
- □ potentially adverse tax consequences;
- □ action by foreign governments or foreign telecommunications companies to limit access to our services;
- □ potentially weaker protection of intellectual property rights; and
- □ uncertain market acceptance and difficulties in marketing efforts due to language and cultural differences.

We have experienced losses as a result of fraud.

We have experienced losses due to fraud. While in 2007 we experienced losses from fraud of less than 1% of our revenues, callers have obtained our services without rendering payment by unlawfully using our access numbers and personal identification numbers. While we have continued to implement anti-fraud measures in order to control losses relating to these practices, and these measures have proven to be effective today, these measures may not in the future be sufficient to effectively limit all of our exposure in the future from fraud and future losses could rise significantly above current levels.

We need to retain key personnel to support our products and ongoing operations.

The marketing and operations of our VoIP products and services will continue to place a significant strain on our limited personnel, management, and other resources. Our future success depends upon the continued services of our executive officers and other key employees who have critical industry experience and relationships that we rely on to implement our business plan. Except for Mr. Shimmy Zimels, our Chief Executive Officer, and Mr. Lior Samuelson, our Chairman of the Board, none of our officers or key employees is bound by employment agreements for any specific term. The loss of the services of any of these officers or key employees could delay the development and introduction of, and negatively impact our ability to sell, our products which could adversely affect our financial results and impair our growth. We currently do not maintain key person life insurance policies on any of our employees.

Our ability to provide our service is dependent upon third-party facilities and equipment, the failure of which could cause delays or interruptions of our service, damage our reputation, cause us to lose customers and limit our growth.

Our success depends on our ability to provide quality and reliable service, which is in part dependent upon the proper functioning of facilities and equipment owned and operated by third parties and is, therefore, beyond our control. Unlike traditional wireline telephone service or wireless service, our service requires our customers to have an operative broadband Internet connection and an electrical power supply, which are provided by the customer's Internet service provider and electric utility company, respectively, and not by us. The quality of some broadband Internet connections may be too poor for customers to use our services properly. In addition, if there is any interruption to a customer's broadband Internet service or electrical power supply, that customer will be unable to make or receive calls, including emergency calls, using our service. We also outsource several of our network functions to third-party providers. For example, we outsource the maintenance of our regional data connection points, which are the facilities at which our network interconnects with the public switched telephone network. If our third-party service providers fail to maintain these facilities properly, or fail to respond quickly to problems, our customers may experience service interruptions. Our customers have experienced such interruptions in the past and will experience interruptions in the future. In addition, our E-911 service is currently dependent upon a third-party provider. Interruptions in service from this vendor could cause failures in our customers' access to E-911 services. Furthermore, we outsource certain aspects of our customer care services. Interruptions in our service caused by third-party facilities or service providers have in the past caused and may in the future cause us to lose customers, or cause us to offer substantial customer credits, which could adversely affect our revenue and profitability. If interruptions adversely affect the perceived reliability of our service, we may have difficulty attracting new customers and our brand, reputation and growth will be negatively impacted.

Third parties might infringe upon our proprietary technology.

We cannot assure you that the steps we have taken to protect our intellectual property rights will prevent misappropriation of our proprietary technology. To protect our rights to our intellectual property, we rely on a combination of trademark and patent law, trade secret protection, confidentiality agreements and other contractual arrangements with our employees, affiliates, strategic partners and others. We may be unable to detect the unauthorized use of, or take appropriate steps to enforce, our intellectual property rights. Effective trademark and trade secret protection may not be available in every country in which we offer or intend to offer our services. Failure to adequately protect our intellectual property could materially harm our brand, devalue our proprietary content and affect our ability to compete effectively. Further, defending our intellectual property rights could result in significant financial expenses and managerial resources.

Our services may infringe on the intellectual property rights of others.

Third parties may assert claims that we have violated a patent or infringed a copyright, trademark or other proprietary right belonging to them. We incorporate licensed third-party technology in some of our products and services. In these license agreements, the licensors have agreed to indemnify us with respect to any claim by a third party that the licensed software infringes any patent or other proprietary right so long as we have not made changes to the licensed software. We cannot assure you that these provisions will be adequate to protect us from infringement claims. Any infringement claims, even if not meritorious, could result in substantial monetary liability or may materially disrupt the conduct of our business.

Risks Related to our Industry

Government regulation and legal uncertainties relating to IP telephony could harm our business.

Historically, voice communications services have been provided by regulated telecommunications common carriers. We offer voice communications to the public for international and domestic calls using IP telephony, and we do not operate as a licensed telecommunications common carrier in any jurisdiction. Based on specific regulatory classifications and recent regulatory decisions, we believe we should not be regulated as a telecommunications common carrier in any of our markets. However, the growth of IP telephony has led to close examination of its regulatory treatment in many jurisdictions making the legal status of our services uncertain and subject to change as a result of future regulatory action, judicial decisions or legislation in any of the jurisdictions in which we operate. Established regulated telecommunications carriers have sought and may continue to seek regulatory actions to restrict the ability of companies such as ours to provide services or to increase the cost of providing such services. In addition, our services may be subject to regulation if regulators distinguish phone-to-phone telephony service using IP technologies over privately-managed networks such as our services from integrated PC-to-PC and PC-originated voice services over the Internet. Some regulators may decide to treat the former as regulated common carrier services and the latter as unregulated enhanced or information services.

Application of new regulatory restrictions or requirements to us could increase our costs of doing business and prevent us from delivering our services through our current arrangements. In such event, we would consider a variety of alternative arrangements for providing our services, including obtaining appropriate regulatory authorizations for our local network partners or ourselves, changing our service arrangements for a particular country or limiting our service offerings. Such regulations could limit our service offerings, raise our costs and restrict our pricing flexibility, and potentially limit our ability to compete effectively. Further, regulations and laws that affect the growth of the Internet could hinder our ability to provide our services over the Internet.

Our international operations are also subject to regulatory risks, including the risk that regulations in some jurisdictions will prohibit us from providing our services cost-effectively or at all, which could limit our growth. Currently, there are several countries where regulations prohibit us from offering service. These regulations have had an impact on us in 2007, particularly in connection with our offering of the joip service. We cannot assure you that these conditions will not have a material effect on our revenues and growth in the future. In addition, because customers can use our services almost anywhere that a broadband Internet connection is available, including countries where providing VoIP services is illegal, the governments of those countries may attempt to assert jurisdiction over us, which could expose us to significant liability and regulation. For a more detailed discussion of the regulation of IP telephony, see "Regulation."

We may not be able to keep pace with rapid technological changes in the communications industry.

Our industry is subject to rapid technological change. We cannot predict the effect of technological changes on our business. In addition, widely accepted standards have not yet developed for the technologies we use. We expect that new services and technologies will emerge in the market in which we compete. These new services and technologies may be superior to the services and technologies that we use, or these new services may render our services and technologies obsolete.

To be successful, we must adapt to our rapidly changing market by continually improving and expanding the scope of services we offer and by developing new services and technologies to meet customer needs. Our success will depend, in part, on our ability to license leading technologies and respond to technological advances and emerging industry standards on a cost-effective and timely basis. We will need to spend significant amounts of capital to enhance and expand our services to keep pace with changing technologies.

The success of our business is affected by customers' unimpeded access to broadband service. Providers of broadband services may be able to block our services, which could adversely affect our revenue and growth.

A portion of our customers must have broadband access to the Internet in order to use our service. Some providers of broadband access have taken measures that affect their customers' ability to use our service, such as degrading the quality of the data packets we transmit over their lines, giving those packets low priority, giving other packets higher priority than ours, blocking our packets entirely or attempting to charge their customers more for also using our services. It is not clear whether suppliers of broadband access services have a legal obligation to allow their customers to access and use our service without interference. As a result of recent decisions by the U.S. Supreme Court and the FCC, providers of broadband services are subject to relatively light regulation by the FCC. Consequently, federal and state regulators might not prohibit broadband providers from limiting their customers' access to VoIP or otherwise discriminating against VoIP providers. Interference with our service or higher charges for using our service could cause us to lose existing customers, impair our ability to attract new customers, and harm our revenue and growth.

We are not currently accepting customers in areas where we cannot provide E-911 service in conformity with the FCC's rules. This has adversely impacted the ability of ICH to accept new customers and may also have an adverse effect on our sales to customers who resell our service.

Various fees and taxes will increase our costs and our customers' cost of using our services.

There are numerous U.S. state and municipal and other fees and taxes assessed on traditional telephone services that we believe have not been applicable to us and that we have not paid in the past. However, we may begin to collect and remit some of these fees and taxes in the future. To the extent we increase the cost of services to our customers to recoup some of these costs of compliance this will have the effect of decreasing any price advantage we may have. Moreover, if we are subject to various state and municipal regulations and taxes in the U.S., this would increase our costs of doing business, and adversely affect our operating results and future prospects.

In addition, it is possible that we will be required to collect and remit sales and excise taxes in several states where we have not done so in the past. We are in the process of discussing the applicability of sales, excise, and other taxes with numerous states and we may proactively enter into discussions with additional states as conditions warrant. In the states where we determine that we need to collect and remit sales and excise taxes, we will comply with the administrative rules existing in that state.

States have taken or may take the position that we should have collected sales and excise taxes in the past. If so, they may seek to collect those past taxes from us and impose fines, penalties or interest charges on us. Our payment of these past taxes and related charges could have a material adverse effect on us.

There may be risks associated with our ability to comply with funding requirements of the USF and similar state or federal funds, or that our customers will cancel service due to the impact of these or other price increases to their service.

On June 21, 2006, the FCC expanded the base of USF contributions to interconnected VoIP providers. The Company may calculate its USF contribution based on any one of three methods: (1) a safe harbor percentage of interstate revenue of 64.9% of total VoIP service revenue, (2) a traffic study that has been approved by the FCC, or (3) reporting based on actual interstate end user telecommunications revenues. The Company is currently calculating its contribution based on the safe harbor. We began contributing to the USF during the fourth fiscal quarter of 2006, and as allowed by the FCC we began charging our end user subscribers a USF surcharge fee equal to the USF contribution amounts we must contribute based upon our subscribers' retail revenues. The USF contribution applies to the revenue from our direct-to-consumer channel. In general, revenue from our Service Provider and Reseller channel is not subject to the contribution because most of our customers from this channel are exempt from USF or make their own contribution. The impact of this price increase on our customers or our inability to recoup the costs or liabilities in remitting USF contributions or other factors could have a material adverse effect on our financial position, results of operations and cash flows.

The FCC continues to evaluate alternative methods for assessing USF charges, including imposing an assessment on telephone numbers. The outcome of the FCC's evaluation cannot be determined at this time.

Risks Related to our Relationship with Atarey

Atarey exercises significant control over all matters submitted to a stockholder vote.

Atarey Hasharon Chevra Lepituach Vehashkaot Benadlan (1991) Ltd., or Atarey, owns approximately 40% of the voting power and economic interest in us, and is the largest holder of our stock. As long as Atarey continues to beneficially own such a significant percentage of our capital stock and there are no other major stockholders, Atarey will be able to exercise a significant influence over decisions affecting us, including:

- composition of our board of directors and, through it, our direction and policies, including the appointment and removal of officers;
- mergers or other business combinations;
- acquisitions or dispositions of assets by us;
- future issuances of capital stock or other securities by us;
- incurrence of debt by us;
- amendments, waivers and modifications to any agreements between us and Atarey;
- payment of dividends on our capital stock; and
- approval of our business plans and general business development.

In addition, one of our five directors is an officer and/or director of Atarey, or otherwise affiliated with Atarey. As a result, the ability of any of our other stockholders to influence the management of our company is limited, which could have an adverse effect on the market price of our stock.

A third party may be deterred from acquiring our company.

Atarey's significant ownership could delay, deter or prevent a third party from attempting to acquire control of us. This may have the effect of discouraging a third party from making a tender offer or otherwise attempting to obtain control of us, even though such a change in ownership would be economically beneficial to us and our stockholders.

Risks Related to our Common Stock

Volatility of our stock price could adversely affect our stockholders.

From the time that trading commenced in our common stock in November 1999, the market price of our common stock has been highly volatile and may continue to be volatile and could be subject to wide fluctuations in response to factors such as:

- the market price for the stock of our major competitors;
- variations in our actual or anticipated quarterly operating results or those of our competitors;
- announcements by us or our competitors of technological innovations;
- introduction of new products or services by us or our competitors;
- conditions or trends in the Internet industry;
- changes in the market valuations of other Internet companies;
- announcements by us or our competitors of significant acquisitions;
- our entry into strategic partnerships or joint ventures; and
- sales of our common stock by Atarey.

All of these factors are, in whole or part, beyond our control and may materially adversely affect the market price of our common stock regardless of our performance.

Investors may not be able to resell their shares of our common stock following periods of volatility because of the market's adverse reaction to such volatility. In addition, the market price for shares of telecommunications, Internet-related and technology companies has dramatically decreased. We cannot assure you that our common stock will trade at the same levels of other telecommunications or Internet stocks or that telecommunications or Internet stocks in general will sustain their current market prices.

The delisting of our common stock from The Nasdaq Capital Market may adversely affect the market price and liquidity of our stock, as well as our business and operations.

Our common stock was delisted from The Nasdaq Capital Market, and began to be listed and traded on the OTC Bulletin Board, on March 28, 2008. As disclosed in the Form 8-K filed by us on March 25, 2008, on March 19, 2008 we received notification from The Nasdaq Stock Market indicating that trading would be suspended and the common stock delisted from the Nasdaq Capital Market at the opening of business on March 28, 2008, unless we chose to appeal Nasdaq's determination. We had received notice from The Nasdaq Stock Market on September 17, 2007 indicating that we were not in compliance with Marketplace Rule 4310(c)(4) because the bid price of the common stock had closed below \$1.00 for the previous 30 consecutive business days. We were provided a period until March 17, 2008 to regain compliance with Rule 4310(c)(4) at which time, if we had not regained compliance, Nasdaq would determine whether we met the Nasdaq Capital Market initial listing criteria set forth in Nasdaq Marketplace Rule 4310(c) except for the bid price requirement. The notification from Nasdaq stated that the Company had not regained compliance with Rule 4310(c)(4) and does not meet the initial listing criteria. The Company chose not to appeal Nasdaq's determination.

The suspension of trading and delisting of our shares from The Nasdaq Capital Market, and listing and trading on the OTC Bulletin Board, may adversely affect the market price of our common stock, as well as the liquidity of the market for our shares which, as a result, may adversely affect the ability of our stockholders to purchase and sell their shares in an orderly manner, or at all. Furthermore, the delisting of our shares could damage our general business reputation and impair our ability to raise additional funds. Any of the foregoing events could have a material adverse effect on our business, financial condition and operating results.

We do not intend to pay dividends.

We have never declared or paid any cash dividends on our common stock. We intend to retain any future earnings to finance our operations and to expand our business and, therefore, do not expect to pay any cash dividends in the foreseeable future.

Risks Related to our Israel-based Office

We may be negatively impacted by changes in political, military and/or economic conditions.

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. A peace agreement between Israel and Egypt was signed in 1979 and a peace agreement between Israel and Jordan was signed in 1994. However, as of the date hereof Israel has not entered into any peace agreement with Syria or Lebanon.

Despite peace related developments, certain countries, companies and organizations continue to participate in a boycott of Israeli firms. We do not believe that the boycott has had a material adverse effect on us, but there can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli-based businesses will not have an adverse impact on our business or financial condition in the future.

Our costs of operations have at times been affected by changes in the cost of our operations in Israel resulting from changes in the value of the Israeli shekel relative to the U.S. dollar. Recently, the weakening of the dollar relative to the shekel has significantly increased the costs of our Israeli operations, stated in U. S. dollars.

Israel's economy has been subject to numerous destabilizing factors, including a period of rampant inflation in the early- to mid-1980s, low foreign exchange reserves, fluctuations in world commodity prices and military conflicts. The Israeli Government has, for these and other reasons, intervened in the economy by utilizing, among other means, fiscal and monetary policies, import duties, foreign currency restrictions and control of wages, prices and exchange rates. The Israeli Government has periodically changed its policies in all these areas. Although we derive most of our revenues outside of Israel, a substantial portion of our expenses are incurred in Israel and are affected by economic conditions in the country.

All of these factors are, in whole or part, beyond our control and may materially adversely affect on our business, financial condition and operating results, or market price of our common stock regardless of our performance.

We may be negatively impacted by employees being called for army service.

Generally, all male adult citizens and permanent residents of Israel under the age of 41 are, unless exempt, obligated to perform up to 36 days of military reserve duty annually. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. Furthermore, some of our officers and employees are currently obligated to perform annual reserve duty. While we have operated effectively under these requirements since we began operations, no assessment can be made as to the full impact of such requirements on our workforce or business if conditions should change, and no prediction can be made as to the effect on us of any expansion of such obligations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We lease our executive offices at 75 Broad Street, New York, New York at an annual cost of approximately \$731,000, which increases annually to \$815,000 for the final year of the lease. The term of the lease is until July 2010, with an option to extend the lease for an additional five years. In October 2003 we entered into a sub-lease agreement with a third party to sub-lease approximately 30% of the overall New York office space. The annual sub-lease income was \$156,000 for 2007, increasing annually to \$168,000 for the final year of the sub-lease, and the term extends until July 2010.

We lease a 1,290 square meter office, which houses our research and development facilities, in Jerusalem, Israel, at an annual cost of \$220,000. In September 2005, we signed an amendment that extended our lease term through December 2009. We have an option to further extend the term of the lease for an additional five years through December 2014.

ITEM 3. LEGAL PROCEEDINGS

On or about August 30, 2007, one of our vendors commenced an action in the Southern District of New York against us for breach of contract, copyright infringement, breach of the duty of good faith and fair dealing and replevin relating to a license agreement that we entered into with the vendor in 2005 to license the vendor's software. In addition, the vendor sought a temporary restraining order and preliminary injunction prohibiting us from using the software during the course of the litigation. The temporary restraining order was denied, however we have since stopped using such vendor's software and have begun using software provided by a different vendor. On February 4, 2008, we filed a motion for partial summary judgment, to which the other side submitted a reply. Although we denied any liability, we argued that the agreement between us and such vendor clearly limits the amount of our total liability to the aggregate amounts we had paid such vendor (\$111,350). Rather than incur the costs and expenses (including attorneys' fees) that would be required to defend the action – which we believe would certainly be greater than \$111,350 – we petitioned the court to require the vendor to accept such amount from us as a full and final settlement of all amounts owing between the parties and, upon our tendering such amount, to dismiss the case. The court has not yet ruled on this motion. In the event that our motion is not granted, we plan to continue to defend the action and do not anticipate that this will be a material event in the event liability is found.

We, as well as certain of our former officers and directors, were named as co-defendants in a number of purported securities class actions in United States District Court for the Southern District of New York, arising out of our initial public offering, or IPO, in November 1999. In addition, a number of other issuers and underwriters of public offerings of such issuers (including the underwriters of our IPO) were named as defendants in such class action suits in connection with such public offerings. A proposed omnibus settlement between the plaintiffs and certain issuer defendants (including us) was suspended when the district court signed a stipulation terminating the settlement approval process. The case is currently being litigated against a small number of focus issuers (which does not include the Company) selected by the district court. If the settlement does not occur, and litigation against us recommences, we believe that we have meritorious defenses to the claims us and we intend to defend the case vigorously.

We are not a party to any other material litigation and are not aware of any other pending or threatened litigation that could have a material adverse effect on us or our business taken as a whole.

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

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2007.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is currently listed on the OTC Bulletin Board under the symbol "DDDC". The listing of our common stock was transferred from The Nasdaq National Market (where it had traded since November 22, 1999) to The Nasdaq Capital Market effective on September 17, 2002, and from The Nasdaq Capital Market to the OTC Bulletin Board effective on March 28, 2008.

The following table sets forth the per share range of high and low closing sales prices of our common stock for the periods indicated:

	<u>High</u>	<u>Low</u>
Year ended December 31, 2006		
First quarter	3.42	2.52
Second quarter	3.19	2.32
Third quarter	2.15	1.56
Fourth quarter	2.03	1.22
Year ended December 31, 2007		
First quarter	1.83	1.32
Second quarter	1.79	1.24
Third Quarter	1.25	0.66
Fourth Quarter	0.77	0.40
Year ended December 31, 2008		
First Quarter (through March 28, 2008)	0.49	0.15

Holdings

As of March 28, 2008, we had 167 holders of record of the 32,870,105 outstanding shares of our common stock. This does not reflect persons or entities that hold their stock in nominee or "street" name through various brokerage firms.

Dividend Policy

We have never declared or paid any cash dividends on our capital stock. We do not anticipate paying any cash dividends on our capital stock in the foreseeable future. We currently intend to retain future earnings, if any, to finance our operations and to expand our business. Any future determination to pay cash dividends will be at the discretion of our board of directors and will be dependent upon our financial condition, operating results, capital requirements and other factors that our board of directors considers appropriate.

Recent Sales of Unregistered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Persons

None.

ITEM 6. SELECTED FINANCIAL DATA

You should read the selected consolidated financial data together with our consolidated financial statements and related notes and the section of this Annual Report entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations." Brightman Almagor & Co., a member firm of Deloitte Touche Tohmatsu, independent certified public accountants, audited our historical financial statements since inception. The selected financial data for each of the years in the three-year period ended December 31, 2007, and as of December 31, 2007 and 2006 is derived from our audited financial statements that have been included in this Annual Report. The selected financial data as of December 31, 2003, 2004 and 2005 and for the years ended December 31, 2003 and 2004 is derived from consolidated financial statements that have not been included in this Annual Report.

	Year Ended December 31,				
	2003	2004	2005	2006	2007
	(In thousands)				
Statement of Operations Data:					
Revenues	\$ 13,162	\$ 21,069	\$ 29,714	\$ 37,953	\$ 29,477
Costs and operating expenses:					
Cost of revenues	(8,393)	(13,791)	(18,698)	(24,375)	(21,107)
Research and development expenses	(2,326)	(2,531)	(3,228)	(4,043)	(4,669)
Selling and marketing expenses	(3,325)	(3,274)	(4,173)	(4,956)	(5,068)
General and administrative expenses	(2,062)	(2,194)	(2,912)	(3,088)	(2,952)
Depreciation and amortization	(5,584)	(2,731)	(1,931)	(1,543)	(2,644)
Write down of intangible asset	-	-	-	-	(2,680)
Total costs and operating expenses	(21,690)	(24,521)	(30,942)	(38,005)	(39,120)
Loss from operations	(8,528)	(3,452)	(1,228)	(52)	(9,643)
Other non-operating income	-	-	-	-	13
Interest income, net	245	269	418	620	442
Income taxes	(57)	(66)	(44)	(61)	(126)
Net loss	\$ (8,340)	\$ (3,249)	\$ (854)	\$ 507	\$ (9,314)
Net loss per share – basic and diluted	\$ (0.29)	\$ (0.11)	\$ (0.03)	\$ 0.02	\$ (0.29)
Weighted average shares outstanding – basic and diluted	28,989	29,316	29,672	29,771	32,427

	December 31,				
	2003	2004	2005	2006	2007
	(In thousands)				
Balance Sheet Data:					
Cash and cash equivalents	\$ 1,682	\$ 4,856	\$ 3,847	\$ 3,790	\$ 1,649
Short-term investments	16,442	10,527	10,648	12,067	5,883
Working capital	14,820	10,285	10,264	12,182	4,522
Long-term investments	--	1,095	1,216	1,085	1,085
Total assets	23,643	22,273	21,504	22,395	17,299
Total stockholder's equity	19,141	16,025	15,561	16,618	12,024

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read together with our consolidated financial statements and the related notes thereto included elsewhere in this Annual Report. This discussion contains certain forward-looking statements that involve substantial risks and uncertainties. When used in this report, words such as "anticipate," "believe," "estimate," "expect," "target," "goal," "project," "intend," "plan," "believe," "seek," variations of such words and similar expressions as they relate to our management or us are intended to identify such forward-looking statements. Our actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in "Risk Factors." Historical operating results are not necessarily indicative of the trends in operating results for any future period.

Overview

We are a leading provider of integrated 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 IP telephony services. While we began as primarily a low-cost alternative source of wholesale minutes for carriers around the world, we have evolved into one of the premier providers of next generation communication services in the world.

Today we support tens of thousands of active users around the globe through our two primary distribution channels: our service provider and reseller channel and our direct-to-consumer channel. We offer a broad suite of private label VoIP products and services as well as a back-office platform for service providers, resellers, and corporate customers, such as incumbent telecommunications providers, Internet service providers, or ISPs, cable companies, licensed VoIP operators, and various corporate enterprises. Based on our customizable VoIP solutions, these customers can offer private label telecommunications to their own customer bases, under their own brand name, a white-label brand, our iConnectHere, or ICH, brand, or the deltathree brand. At the same time, our direct-to-consumer channel includes our iConnectHere offering (which provides VoIP products and services directly to consumers and small businesses online using the same primary platform) and our recently established joip offering (which serves as the exclusive VoIP service provider embedded in the Globalrange cordless phones of Panasonic, the world leader in consumer cordless phones). This joip-enabled phone first became available in August 2007 and is currently available in the United States, Canada, United Kingdom and Ireland, Germany, Spain and Austria.

In our service provider and reseller channel, we combined our global reseller program with our Hosted Consumer VoIP Solution. We gradually moved in this direction in 2005 and 2006 because we realized that the lines of differentiation between service provider customers and reseller customers continue to narrow as these customers grow increasingly similar. Both resellers and service providers are looking to leverage their own unique brands by selling sophisticated products and services to their own customers under their own brand, with their own look and feel. As such, our reseller customers are looking for advanced VoIP feature sets and applications to support their ability to deliver unique calling plans and bundled services to their end customers. For several years we have offered businesses the opportunity to become resellers of our services through our global reseller program. In the early years of the life of our Company, these resellers met their customers' needs by purchasing account numbers in bulk at reseller specific rates, and they in turn resold these accounts to private individuals under the deltathree brand, their own brand, or as a "white-label". As our resellers became more sophisticated, we introduced new features and functions that allowed them to develop their own unique price plans and service bundles to more closely align their offerings with their own customers' unique needs. In addition, we developed, and continue to develop, increasingly sophisticated online toolsets to allow our resellers to better manage their internal processes and enable them to utilize our web-based customer care tools to provide customer service to their end-users through their own customer service team. During 2005 and 2006, we realized that our global reseller business model was aligned with our Hosted Consumer VOIP Solution business model because customers for both of these products and services already had access to the same features and functions. We, therefore, decided to combine these customer groups. We believe that this group will be more strategically aligned with the market and we expect to benefit from synergies from both of these customer bases.

Within the new Service Provider and Reseller Channel, in 2007 we entered into an agreement with Market America, a leading on-line shopping and one-to-one marketing company, pursuant to which Market America launched its Voitel Home Phone Service powered by our Hosted Consumer VoIP Solution platform. In addition, we entered into an agreement with RCN Corporation, a leading provider of video, data, and voice services to residential, business, and commercial/carrier customers, to power its new Starpower Internet Phone Service.

Our direct-to-consumer channel includes our recently established joip offering, which serves as the exclusive VoIP service provider embedded in the Globalrange cordless phones of Panasonic, and our iConnectHere offering. Prior to the launch of our joip offering, iConnectHere was traditionally our direct-to-consumer channel. iConnectHere demonstrates our products, services and hosting capabilities to our reseller customers and service providers. Through iConnectHere, an account holder can access all of our product offerings, including PC-to-Phone and Broadband Phone. Additionally, iConnectHere permits us to collect usage information on our products and services and enables us to provide our service provider and reseller customers with key information and recommendations regarding implementation of our products and services. As for our joip offering, Panasonic and we have created, developed and are offering joip-enabled Panasonic Globalrange telephones pursuant to our strategic cooperation which began in 2006. Our joip offering serves as the exclusive VoIP service embedded in Panasonic's Globalrange series of innovative hybrid 2-line cordless phones, which provide both landline and VoIP services. Because our VoIP services are embedded in this hybrid cordless telephone, there is no requirement for any software downloads, external adaptors or other complicated procedures. Additionally, customers of the

Globarange telephones will be able to talk to each other for free through the use of the joip service, and will also be able to purchase a variety of enhanced features and value-added services. This phone first became available in August 2007. Through our joip offering and extensive experience in VoIP services and Panasonic's consumer electronics expertise and vast distribution channels, Panasonic and we aim to create a global community by providing free calling between joip-enabled Globarange phones in all regions of the world as we expand our reach in our direct to consumer channel.

As a complement to the initiatives we plan to take to organically expand our businesses, we have also been evaluating opportunities for inorganic growth through strategic acquisitions and unique collaborations. In February 2007, we acquired the service provider and consumer businesses, including the customer bases, of Go2Call for cash and our stock valued at approximately \$7.0 million.

Going forward, we expect to:

- continue to devote our resources to develop and expand our Service Provider and Reseller base and we expect our revenue from this key channel to represent a significant percentage of our total revenue in the foreseeable future;
- actively market our products and services to a large number of broadband operators, incumbent telecommunication providers, cable companies, ISP's, licensed VoIP operators, corporate enterprises, and consumer oriented retailers around the world; and
- pursue a targeted strategy of identifying and evaluating appropriate acquisition candidates and collaborations that will continue to expand and diversify our customer base.

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. These decreases were driven largely by reduced vendor pricing associated with our increased purchasing power and, to a lesser extent, cost savings associated with an increasing portion of calls between users of our own services, which have no termination costs associated with them. 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 emergent "next generation" telecommunications providers, including IP telecommunications providers, in supplying the overall telecommunications needs of businesses and individual consumers, and several of the larger traditional telecommunications companies have announced intentions to merge, which will create even larger competitors. We compete with other telecommunications firms in the sale and purchase of various products and services in many national and international markets and employ all methods of competition that are lawful and appropriate for such purposes. 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 VoIP telephony 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 increases 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 and by other political developments and laws and regulations, such as forced divestiture of assets; restrictions on production, imports and exports; war or other international conflicts; civil unrest and local security concerns that threaten the safe operation of company facilities; price controls; tax increases and retroactive tax claims; expropriation of property; cancellation of contract rights; and telecommunications regulations. 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 affects us in a positive manner 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 Factor: 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 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, CALEA, CPNI and electronic privacy, and proposed reforms for the inter-carrier compensation system. 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.

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: See “—Risk Factors” for a discussion of the impact of market risks, financial risks and other uncertainties.

Revenues

Our revenues are derived mainly from resellers, service providers, and end-users of our VoIP telephony products and services, including PC-to-Phone, and Broadband Phone. All revenues are recognized at the time the services are performed. The provision of VoIP telephony products and services through our service provider and reseller sales efforts (including sales of our Hosted Consumer VoIP Solution) accounted for 85.2% and 73.7% of our total revenues in 2007 and 2006, respectively, while the provision of VoIP telephony (primarily PC-to-Phone) through iConnectHere accounted for 13.4% and 22.4% of our total revenues in 2007 and 2006, respectively.

Costs and Operating Expenses

Costs and operating expenses consist of cost of revenues, research and development expenses, selling and marketing expenses, general and administrative expenses, non-cash stock compensation, write-down of intangible assets and depreciation and amortization.

- Cost of revenues consist primarily of 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. In the future, these expenses may fluctuate as a percentage of revenue depending on the project undertaken during the reporting period. 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 consumer users of iConnectHere.
- General and administrative expenses consist primarily of compensation and benefits for management, finance and administrative personnel, occupancy costs and legal and accounting fees, as well as the expenses associated with being a public company, including the costs of directors' and officers' insurance.
- Write-down of intangible assets consists of management's assessment of the remaining value of the intangible assets acquired by the Company in the purchase of certain assets of Go2Call.
- Depreciation and amortization consists of the depreciation calculated on the Company's fixed assets for the fiscal year ended December 31, 2007, and the amortization of the intangible assets acquired by the Company in the purchase of certain assets of Go2Call.

We have not recorded any income tax benefit for net losses and credits incurred for any period from inception to December 31, 2007. 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.

Critical Accounting Policies

The SEC defines critical accounting policies as those that are, in management's view, most important to the portrayal of a company's financial condition and results of operations and most demanding on their calls on judgment, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. We believe our most critical accounting policies relate to:

Revenue recognition and deferred revenue: We record revenue from Internet telephony services based on minutes (or fractions thereof) of customer usage. We record revenue from related services based on completion of the specific activities associated with the services. We record payments received in advance for prepaid services and services to be supplied under contractual agreements as deferred revenue until such related services are provided. We estimate the allowance for doubtful accounts by reviewing the status of significant past due receivables and analyzing historical bad debt trends and we then reduce accounts receivables by such allowance for doubtful accounts to expected net realizable value.

Long-lived Assets: We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include the following:

- significant decrease in the market price of a long-lived asset (asset group);
- significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition;
- significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator;
- accumulation of costs significantly in excess of the amount originally expected for the acquisition of the long-lived asset (asset group);
- current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group); and
- current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

We determine the recoverability of long-lived assets based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Such estimation process is highly subjective and involves significant management judgment. Determination of impairment loss from long-lived assets to be disposed of is reported at the lower of carrying amount or fair value less costs to sell.

Results of Operations

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

	Year Ended December 31,		
	2007	2006	2005
Revenues:			
Total revenues	100.0	100.0	100.0
Costs and operating expenses:			
Cost of revenues	71.6	64.2	62.9
Research and development expenses	15.8	10.7	10.9
Selling and marketing expenses	17.2	13.1	14.0
General and administrative expenses (exclusive of non-cash compensation expense)	10.0	8.1	9.8
Write down of intangible asset	9.1	-	-
Depreciation and amortization	9.0	4.1	6.5
Total costs and operating expenses	132.7	100.1	104.1
Loss from operations	(32.7)	(0.1)	(4.1)
Other non-operating income	-	-	-
Interest income, net	1.5	1.6	1.4
Income taxes	(0.4)	(0.2)	(0.1)
Net Income (loss)	<u>(31.6)%</u>	<u>1.3%</u>	<u>(2.9)%</u>

Comparison of 2007 and 2006

Revenues

Revenues overall decreased approximately \$8.5 million or 22.4% to approximately \$29.5 million in 2007 from approximately \$38.0 million in 2006. All of our revenue channels were affected. Revenues from VoIP telephony through our service provider and reseller sales efforts (both pre-paid and post-paid) decreased approximately \$6.2 million or 19.8% from approximately \$31.3 million in 2006 to approximately \$25.1 million in 2007. In addition, revenues from VoIP telephony (primarily PC-to-Phone) through iConnectHere decreased approximately \$1.8 million or 31.6% from approximately \$5.7 million in 2006 to approximately \$3.8 million in 2007. Revenues generated by our Hosted Consumer VoIP Solution division decreased by approximately \$0.9 million or 13.8% from \$6.5 million in 2006 to approximately \$5.6 million in 2007.

Our revenue decrease can be attributed to a number of factors, the most important being an increasingly competitive VoIP market causing market rates to decline. We made a decision not to change our existing policy regarding retaining certain margin rates and thus did not significantly lower our rates. As a result, the number of minutes on our network utilized by our resellers and end-users dropped by approximately 29% from 538 million in 2006 to 380 million in 2007.

Furthermore, our reseller revenues, which made up approximately 65% of our overall revenues in both 2006 and 2007, were adversely affected by regulatory problems in key destinations. In addition, the introduction of several competitors offering lower prices than ours to our biggest markets further adversely affected our revenues. Revenues generated by resellers we acquired in the Go2Call acquisition amounted to approximately \$3.0 million or 15.4% of our reseller revenues in 2007.

Revenues generated by ICH declined by approximately \$1.8 million or 33.3% from \$5.7 million in 2006 to \$3.8 million in 2007. This resulted in part from a decision we made to invest our time and resources in other areas.

Revenues from our Hosted Consumer VoIP Solution division decreased by approximately \$0.9 million or 13.8% from \$6.5 million in 2006 to \$5.6 million in 2007, largely due to the expiration of our agreement with SBC.

No customer accounted for ten percent or more of our sales during 2007.

Costs and Operating Expenses

Cost of revenues. Cost of revenues decreased by \$3.3 million or 13.5% from \$24.4 million in 2006 to \$21.1 million in 2007. Although our network rent cost increased by 37.5% from \$0.8 million in 2006 to \$1.1 million in 2007, our termination cost decreased by 20.1% from \$19.9 million in 2006 to \$15.9 million in 2007. The main reason for the decrease in cost of revenues was a reduction in the amount of traffic being terminated over our network.

Research and development expenses. Research and development expenses increased by \$0.7 million or 17.5% from \$4.0 million in 2006 to \$4.7 million in 2007. Salary expenses increased by 16.6% to \$3.5 million in 2007 from \$3.0 million in 2006. The main reason for the increase was the cost associated with the development of the new services associated with joip and enhancements to our existing services.

Selling and marketing expenses. Selling and marketing expenses increased by \$0.1 million or 2.0% to \$5.1 million in 2007 from \$5.0 million in 2006. The cost of our selling and marketing personnel increased by approximately 8.3% to \$2.6 million in 2007 from \$2.4 million in 2006 due to an increase in branding and promotional activities.

General and administrative expenses. General and administrative expenses decreased by \$0.1 million or 3.2% to \$3.0 million in 2007 from \$3.1 million in 2006.

Depreciation and amortization. Depreciation and amortization increased by \$1.1 million or 73.3% from \$1.5 million in 2006 to \$2.6 million in 2007 due to a higher relative level of capital expenditures in 2006 compared to prior years and periodic amortization of intangible assets.

Loss from Operations

Loss from operations increased by \$9.5 million or 9,500% from \$0.1 million in 2006 to \$9.6 million in 2007, due primarily to the decrease in revenues, increase in costs and operating expenses (including selling and marketing expenses) and a one time amortization charge.

Interest Income, Net

We earned interest income of \$0.4 million in 2007 compared to \$0.6 million in 2006 due primarily to interest earned on the remaining proceeds from our IPO.

Income Taxes, Net

We paid net income taxes of \$126,000 in 2007 compared to \$61,000 in 2006.

Net Income/Loss

Net Income decreased by \$9.8 million or 1,960% from \$0.5 million in 2006 to a loss of \$9.3 million in 2007, due to the foregoing factors.

Comparison of 2006 and 2005

Revenues

Revenues increased approximately \$8.3 million or 27.9% to approximately \$38.0 million in 2006 from approximately \$29.7 million in 2005. Revenues from VoIP telephony through our service provider and reseller sales increased approximately \$9.4 million or 37.9% to approximately \$30.2 million in 2006 from approximately \$21.9 million in 2005, due primarily to a greater number of PC-to-Phone and Broadband Phone calls being placed by an increasing user base. Revenues from VoIP telephony (primarily PC-to-Phone) through iConnectHere decreased approximately \$0.9 million or 13.6% to approximately \$5.7 million in 2006 from approximately \$6.6 million in 2005 due primarily to a lower number of PC-to-Phone and Broadband Phone calls being placed by a decreasing user base. No customer accounted for ten percent or more of our sales during 2006.

Overall, our revenue growth can be attributed to the increase in the number of active accounts on our network of \$146,400 or 52.5%, if you compare the growth from the fourth quarter of 2005 to the fourth quarter of 2006. In addition, the number of minutes on net was 583.0 million, an increase of 202.1 million or 53.1% as compared to the year ended December 31, 2005. The growth in active users and minutes are significant improvements operationally. Further, the Company believes that the increase in active users is a good indication of prospective growth in the future and that the increased level of promotions on our network during the fourth quarter will translate into stronger customer sales going forward.

Costs and Operating Expenses

Cost of revenues. Cost of revenues increased by \$5.7 million or 30.5% to \$23.4 million in 2006 from \$18.7 million in 2005, due primarily to an increase in the amount of traffic being terminated.

Research and development expenses. Research and development expenses increased by \$0.8 million or 25.0% to \$4.0 million in 2006 from \$3.2 million in 2005, due to increased personnel costs associated with the development of new services and enhancements to our existing services.

Selling and marketing expenses. Selling and marketing expenses increased by \$0.8 million or 19.0% to \$5.0 million in 2006 from \$4.2 million in 2005, due to an increase in branding and promotional activities.

General and administrative expenses. General and administrative expenses increased by \$0.2 million or 6.9% to \$3.1 million in 2006 from \$2.9 million in 2005, primarily due to increased personnel and occupancy costs.

Depreciation and amortization. Depreciation and amortization decreased by \$0.4 million or 21.1% to \$1.5 million in 2006 from \$1.9 million in 2005, due to a lower relative level of capital expenditures in 2006 compared to prior years.

Loss from Operations

Loss from operations changed by \$1.2 million or 95.8% to \$0.1 million in 2006 from \$1.2 million in 2005, due primarily to the decrease in costs and operating expenses, including selling and marketing expenses.

Interest Income, Net

We earned interest income of \$0.6 million in 2006 compared to \$0.4 million in 2005 due primarily to moderately higher interest rates earned on the moderately reduced balance of the remaining proceeds from our initial public offering.

Income Taxes, Net

Income tax expense remained consistent at \$0.1 million for 2006 and 2005. Although the Company had net income of \$0.5 million, we expect that our net operating loss carryforwards will protect most of the net income in 2006 and going forward.

Net Income/Loss

Net Income increased \$1.4 million or 155.6% to \$0.5 million in 2006 from a loss of \$0.9 million in 2005, due to the foregoing factors.

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. For the year ended December 31, 2007, our Net Loss from Operations increased by \$9.5 million or 9,400% from \$0.1 million in 2006 to \$9.6 million in 2007. To date, the Company has an accumulated deficit of approximately \$160.8 million.

As of December 31, 2007, we had cash and cash equivalents of approximately \$1.6 million, restricted cash and short-term investments of approximately \$5.9 million, and long-term investments of approximately \$1.1 million, or a total of cash, cash equivalents, restricted cash and investments of \$8.6 million, a decrease of \$8.3 million from December 31, 2006. In addition, we had working capital of approximately \$4.5 million, down from \$12.2 million in 2006 or a net change of \$7.7 million. The decrease in cash, restricted cash, and short and long term investments was primarily caused by a combination of the net cash used in operating activities of approximately \$5.1 million, cash used in the purchase of certain assets of Go2Call of approximately \$2.5 million and cash used to purchase property and equipment of approximately \$0.7 million. In addition, the Company invested significantly in developing the joip network. During 2007, our average monthly cash burn was approximately \$0.5 million (including cash used in our operations and our capital expenditures), and for the fourth quarter of 2007 the average monthly cash burn increased to approximately \$0.6 million. Looking forward, we estimate that the average monthly cash burn rate for the first quarter of 2008 increased to approximately \$0.8 million, and in total will result in an overall cash burn for the quarter of approximately \$2.5 million. The increase in the cash burn during the first quarter of 2008 is the result of an overall decrease in sales, as well as certain working capital commitments from 2007 that were paid in 2008. On March 24, 2008, our management and Board of Directors formulated a plan that we believe will conserve cash going forward by realigning our cost structure with our current business model. Accordingly, we have begun to reduce our operations and expenses (including a significant reduction in work force) in order to immediately reduce the cash burn rate. Based on our plan, we believe that if we are able to maintain our current revenues we will be able to immediately reduce our cash burn to approximately \$250,000 per month. We believe that the Company will have enough cash for the next twelve months without any increase in our current revenues. In addition, with the assistance of outside strategic consultants we have begun the process of examining ways to possibly increase our current revenues by growing our current sales and/or entering into new sales channels.

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 \$5.1 million during 2007 compared with positive cash flow from operating activities of approximately \$2.0 million during 2006. The decrease in our cash generated from operating activities was primarily driven by our net loss of \$9.3 million plus changes in working capital of approximately \$1.8 million which were offset by our write-off of a portion of the intangible assets we acquired in the Go2Call transaction of \$2.7 million and depreciation and amortization of \$2.6 million. As described above, we have begun a process of immediately reducing our expenses (including a significant reduction in work force) in order to halt the continuing loss from operations.

Net cash used in investing activities is generally driven by our annual capital expenditures and changes in our short and long term investments. In 2007, we spent \$0.7 million on capital expenditures, reduced our investments by \$6.2 million and used approximately \$2.5 million in cash to purchase the assets of Go2Call, for a net use of cash of \$3.0 million. In 2006, we spent \$0.9 million on capital expenditures and increased our investments by \$1.4 million, for a net increase of \$2.2 million. In 2008, we have budgeted capital expenditures of approximately \$0.8 million in connection with the upgrade of our primary data center. We have secured capital leases for much of the hardware that has been purchased to date in accordance with our budget for 2008 and will continue to draw down on our investments until such time as we are able to halt the cash burn.

On February 19, 2007, the Company completed the purchase of certain assets of Go2Call, including the assumption of certain deferred income, for approximately \$7.7 million. The Company paid approximately \$2.5 million in cash and issued approximately 3.0 million shares of our common stock. Additionally, the Company paid approximately \$0.5 million in transaction-related costs and expenses.

Financing cash flows consist primarily of proceeds from exercise of employee options. During 2007 and 2006 our employees exercised options of \$0.03 million and \$0.07 million, respectively.

We obtained our funding from our utilization of the remaining proceeds from our IPO, offset by positive or negative cash flow from our operations. These proceeds are maintained as cash, restricted cash, and short and long term investments. To the extent that the current trends remain steady and we are not able to execute the plan that we adopted on March 24, 2008, we will be required to raise additional funds for our ongoing operations. Additional financing may not be available when needed or, if available, such financing may not be on terms favorable to us. If additional funds are raised through the issuance of equity securities, our existing stockholders may experience significant dilution. If additional funds are raised through the issuance of debt securities, we may not be able to obtain additional subsequent financing, if necessary, if the debt security contains certain covenants restricting our ability to obtain additional financing while such debt security is outstanding. We cannot assure you that any third party will be willing or able to provide additional capital on favorable terms or at all.

Contractual Obligations and Commercial Commitments

The following table sets forth our future contractual obligations and commercial commitments in total, for each of the next five years and thereafter:

Contractual obligations	Payments due by period (in thousands of dollars)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Real estate leases	3,801	1,074	1,829	449	449
Auto leases	667	354	313	-	-
Capital leases	213	69	144	-	-
Purchase obligations	-	-	-	-	-
Total	4,681	1,497	2,286	449	449

Off-Balance Sheet Arrangements

None.

Certain Factors That May Affect Future Results of Operations

The SEC encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This Annual Report on Form 10-K contains such "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, as amended.

Words such as "may," "anticipate," "estimate," "expects," "projects," "intends," "plans," "believes" and words and terms of similar substance used in connection with any discussion of future operating or financial performance, identify forward-looking statements. All forward-looking statements are management's present expectations of future events and are subject to a number of risks and uncertainties that could cause actual results to differ materially and adversely from those described in the forward-looking statements. These risks include, but are not limited to, those set forth under the heading "Risk Factors" contained in Item 1A of this Annual Report on Form 10-K.

In light of these assumptions, risks and uncertainties, the results and events discussed in the forward-looking statements contained in this Annual Report on Form 10-K or in any document incorporated by reference might not occur. Stockholders are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. All subsequent forward-looking statements attributable to deltathree or to any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The federal securities law requires that we describe and quantify our potential losses from market risk sensitive instruments attributable to reasonably possible market changes. Market risk sensitive instruments include all financial or commodity instruments and other financial instruments (such as investments and debt) that are sensitive to future changes in interest rates, currency exchange rates, commodity prices or other market factors. We believe our exposure to market risk is not material.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Company's Consolidated Financial Statements required by this Item are set forth in Item 15 beginning on page 50 of this Annual Report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures.* 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) as of the end of the period covered by this Annual Report on Form 10-K, has concluded that, based on such evaluation, our disclosure controls and procedures were adequate and effective to ensure that material information relating to us, including our consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this Annual Report on Form 10-K was being prepared.

(b) *Management's Report on Internal Control over Financial Reporting.* Management is responsible for establishing and maintaining adequate internal control over financial reporting of the Company. We maintain internal control over financial reporting designed 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.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Therefore, internal control over financial reporting determined to be effective provides only reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management has evaluated internal control over financial reporting by the Company using the framework for effective internal control established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management has assessed the effectiveness of the Company's internal controls over financial reporting as of December 31, 2007. Based on this assessment, we believe that the internal control over financial reporting of the Company was effective as of December 31, 2007. In connection with this assessment, there were no material weaknesses in the Company's internal control over financial reporting identified by management.

This Annual Report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the SEC that permit the Company to provide only management's report in this Annual Report.

(c) *Changes in Internal Controls.* There were no changes in our internal control over financial reporting, identified in connection with the evaluation of such internal control, which occurred during the fourth quarter of our last fiscal year that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Listed below for our named executive officers (as determined in the Summary Compensation Table set forth in the Executive Compensation section below) are the salaries that were awarded during fiscal 2007, the bonuses that were earned for performance during 2007 but awarded in 2008, and the salaries that have been established for fiscal 2008. Bonuses for fiscal 2008 have not yet been determined.

Executive Officer	2007 Salary (\$)	2007 Bonus (1) (\$)	2008 Salary (\$)
Shimmy Zimels <i>Chief Executive Officer and President</i>	258,005(2)	0	258,005(2)
Guy Gussarsky <i>Executive VP Sales and Business Development</i>	13,015(3)	0(4)	0(4)
Richard Grant <i>Senior VP of Finance and Treasurer</i>	175,000	0	175,000

(1) Bonus shown is the aggregate amount of bonuses earned by the executive in 2007, under our Amended and Restated 1999 Performance Incentive Plan, for his performance during 2007.

(2) Salary is pursuant to Mr. Zimels' employment agreement.

(3) This amount represents Mr. Gussarsky's salary and commissions through the date of his resignation on February 14, 2007.

(4) Mr. Gussarsky resigned effective as of February 14, 2007.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The Board of Directors

Our Amended and Restated Certificate of Incorporation provides that a director shall hold office until the annual meeting for the year in which his or her term expires except in the case of elections to fill vacancies or newly created directorships. Each director is elected for a one-year term. Each of the nominees is now serving as director on our Board. Set forth below are the name, age and the positions and offices held by each of our directors, his principal occupation and business experience during at least the past five years and the names of other publicly-held companies of which he serves as a director.

Noam Bardin, 36, Mr. Bardin served as Chairman of the Board from April 2002 until January 2008. Since January 2007, Mr. Bardin has been the Chief Executive Officer of Arootz, Inc., a private broadband TV content enabler and network provider. Mr. Bardin co-founded deltathree and served as Chief Executive Officer and President of deltathree from July 2000 through June 2002. Mr. Bardin served as Vice President of Technology and Chief Technology Officer of deltathree since June 1997, before being named President and Chief Executive Officer in April 2000. He served as Global Network Director of deltathree from November 1996 to May 1997. Prior to founding deltathree, he served as Director of Operations at Ambient Corporation. Mr. Bardin earned a B.A. in Economics from the Hebrew University (Jerusalem) and an M.P.A. from the Harvard University Kennedy School of Government.

Ilan Biran, 61, Director. Mr. Biran has served as a director of deltathree since December 2003. Mr. Biran brings a wealth of business and management experience from the telecom and defense industries. From January 2004 through June 2006, Mr. Biran has served as the Chairman of YES Satellite Television, one of the leading satellite television companies in Israel. From 1999 to 2003, Mr. Biran served as the President and Chief Executive Officer of Bezeq Ltd. - the Israeli PTT, with annual sales of over \$2 billion and approximately 16,000 employees. Mr. Biran holds the rank of Major General (res.) in the Israeli Defense Force where, as Commander of the IDF's Central Command, he played an active role in reaching the peace agreements with Jordan. From 1996 to 1999, he served as the Director General of the Israeli Ministry of Defense, and prior to that command, he held a wide variety of senior-level positions in other Israeli units, since 1964. Mr. Biran holds a B.A. in Economics and Business Administration from Bar-Ilan University, and holds an Associate Diploma in Strategy and Political Economic Research from Georgetown University. He is also a graduate of the U.S. Marine Corps Command and Staff College. In addition, Mr. Biran's public activities include: serving as the Israeli Prime Minister's Special Coordinator for POWs and MIAs, and since 1996, has served as the Chairman of the Board of Directors of the Israeli Oil Refineries, Ltd.

Benjamin Broder, 44, Director. Mr. Broder has served as a director of deltathree since July 24, 2005. As of 2002, Mr. Broder has served as the Finance Director of Atarey. From 1996 to 2001, Mr. Broder worked as the chief financial officer of a telecom start-up company and a bio-tech start-up company. Previously, Mr. Broder also held various positions with several leading banks, including HSBC, Bank Hapoalim, and Bank of Israel. Mr. Broder earned a B.S. degree in Economics from University of London. Mr. Broder is a Chartered Accountant in the U.K. and a C.P.A. in Israel.

Lior Samuelson, 57, Chairman of the Board. Mr. Samuelson has served as a director of deltathree since August 2001 and as Chairman of the Board since January 2008. Since August 1999, Mr. Samuelson has served as a Co-Founder and Principal of Mercator Capital. His experience includes advising clients in the Technology, Communications and Consumer sectors on mergers, acquisitions and private placements. From March 1997 to August 1999, Mr. Samuelson was the President and Chief Executive Officer of PricewaterhouseCoopers Securities. Prior to that, he was the President and Chief Executive Officer of The Barents Group, a merchant bank specializing in advising and investing in companies in emerging markets. Mr. Samuelson was also the Co-Chairman of Peloton Holdings, a Private Equity management company. Before that, he was a managing partner with KPMG and a senior consultant at Booz, Allen & Hamilton. Mr. Samuelson earned B.S. and M.S. degrees in Economics from Virginia Polytechnic University.

Shimmy Zimels, 42, Chief Executive Officer and President and Director. Mr. Zimels has served as Chief Executive Office and President since June 2002, and served as Vice President of Operations and Chief Operating Officer of deltathree since June 1997, before being named President and Chief Executive Officer in June 2002. Prior to joining deltathree, Mr. Zimels was the Controller and Vice President of Finance at Net Media Ltd., a leading Israel based Internet Service Provider, from June 1995 to June 1997. From April 1991 to May 1995, Mr. Zimels was a senior tax auditor for the Income Tax Bureau of the State of Israel. Mr. Zimels graduated with distinction from Hebrew University with a degree in Economics and Accounting and holds a Masters in Economics from Hebrew University.

Executive Officers and Key Employees

Set forth below is a brief description of the present and past business experience of each of the persons who currently serve as our executive officers or key employees who are not also serving as directors.

Richard Grant, 44, Senior Vice President of Finance and Treasurer. Mr. Grant joined deltathree on January 23, 2006. Mr. Grant is a Certified Public Accountant. Prior to his employment with deltathree, Mr. Grant was a co-founder and Chief Financial Officer of Tel2Net, Inc., a technology infrastructure service company. From 2001 through 2003, Mr. Grant served as a Senior Manager for Marotta, Gund, Budd and Dzera LLP, a business restructuring consulting company. Prior to Marotta, Gund, Mr. Grant was a Senior Manager at KPMG LLP in the Audit Division, and a Senior Manager at Arthur Andersen LLP in the Transaction Advisory Services Group. Mr. Grant earned a B.A. in Business Administration-Accounting at Adelphi University.

Efraim Baruch, 32, Senior Vice President of Operations and Technology. In January 2007, Mr. Baruch became our Senior Vice President of Operations and Technology. Mr. Baruch has been with deltathree since 1998. Mr. Baruch began working with deltathree as an engineer in the Network Operation Center (NOC), and soon after specialized in the management of data networks and security at the Wide Area Network (WAN) department. During the past four years he has headed the deltathree VoIP data and security departments, along with managing the overall responsibility of the total uptime in the deltathree worldwide network. Mr. Baruch received his B.A. in Computer Science from Hadassah College and is a CCNP (Cisco Certified Network Professional).

Peter Friedman, 37, General Counsel and Secretary. In October 2007, Mr. Friedman became our General Counsel and Secretary. Mr. Friedman's experience is in the areas of securities offerings and compliance, mergers and acquisitions, corporate governance, venture capital financing, technology licensing, joint ventures, and general corporate and commercial matters. Before joining deltathree, Mr. Friedman served as Senior Associate of Outside Counsel Solutions, a division of IDT Corporation that outsources U.S. legal services. Prior to that, Mr. Friedman was associated with the law firms of Weil, Gotshal & Manges, LLP, Lowenstein Sandler PC and Kronish Lieb Weiner & Hellman, LLP. Mr. Friedman holds a B.A. from Brown University and a J.D. from New York University School of Law.

Board of Directors and Committees of the Board

Our Amended and Restated Certificate of Incorporation provides that the number of members of our Board shall be not less than three and not more than thirteen. There are currently five directors on the Board. At each annual meeting of stockholders, directors are elected to hold office for a term of one year and until their respective successors are elected and qualified. All of the officers identified above under "Executive Officers" serve at the discretion of our Board.

The Board had nine regular meetings during the fiscal year ended December 31, 2007. During the fiscal year ended December 31, 2007, each member of the Board participated in at least 75% of all Board and applicable committee meetings held during the period for which he was a director. Except for Mr. Zimels, none of our other directors attended our 2007 Annual Stockholder Meeting. The Board has established an Audit Committee and a Compensation Committee, but dissolved the Nominating and Governance Committee as of September 11, 2006. The functions of the remaining committees and their current members are set forth below.

Due to a decrease in the number of members of the Board after our 2006 Annual Stockholders Meeting, our Board members determined that it is efficient and important for each member to actively participate in all matters that were previously the responsibility of the Nominating and Governance Committee. As such, each of our Board members participates in, among other matters, the following nominating and governance-related matters:

- identifying and recommending qualified candidates for director, and recommending the director nominees for our annual meetings of stockholders;
- conducting an annual review of the Board's performance;
- recommending the director nominees for each of the Board committees; and
- developing and recommending our company's corporate governance guidelines.

Furthermore, our Board adopted a nominating and governance policy that was based on the former Nominating and Governance Committee Charter. This policy outlines our Board's goals, responsibilities, and procedures related to nominating and governance matters. In this regard, our Board may consider candidates recommended by stockholders as well as from other sources such as other directors or officers, third party search firms or other appropriate sources. For all potential candidates, the Board may consider all factors it deems relevant, such as a candidate's personal integrity and sound judgment, business and professional skills and experience, independence, knowledge of the industry in which we operate, possible conflicts of interest, diversity, the extent to which the candidate would fill a present need in the Board, and concern for the long-term interests of our stockholders. In general, persons recommended by stockholders will be considered on the same basis as candidates from other sources. If a stockholder wishes to nominate a candidate to be considered for election as a director at our 2008 Annual Meeting of Stockholders using the procedures set forth in the Company's Amended and Restated By-laws, it must follow the procedures described under "Nomination of Directors" in our By-laws. If a stockholder wishes simply to propose a candidate for consideration as a nominee by our Board, it should submit any pertinent information regarding the candidate to the Chairman of the Board by mail at 75 Broad Street, New York, New York 10004.

The Compensation Committee is responsible for:

- evaluating our compensation policies;
- determining executive compensation, and establishing executive compensation policies and guidelines; and
- administering our stock option and compensation plans.

As part of these responsibilities, the Compensation Committee determines the compensation of our Chief Executive Officer, and conducts its decision making process with respect to this issue without the presence of the Chief Executive Officer. The Compensation Committee had four meetings during 2007. Benjamin Broder (Chairman) and Ilan Biran are the current members of the Compensation Committee.

The Audit Committee is responsible for:

- recommending to the Board the appointment of the firm selected to serve as our independent auditors and monitoring the performance of such firm;
- reviewing and approving the scope of the annual audit and evaluating with the independent auditors our annual audit and annual financial statements;
- reviewing with management the status of internal accounting controls;
- evaluating issues having a potential financial impact on us which may be brought to the Audit Committee's attention by management, the independent auditors or the Board;
- evaluating our public financial reporting documents; and
- reviewing the non-audit services to be performed by the independent auditors, if any, and considering the effect of such performance on the auditor's independence.

Ilan Biran (Chairman) and Noam Bardin are the current members of the Audit Committee. The Board has determined that each of Mr. Bardin and Mr. Biran are “audit committee financial experts,” as the SEC has defined that term in Item 401 of Regulation S-K. The Audit Committee had six meetings during 2007.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, requires our directors and executive officers and persons who own more than 10% of a registered class of our equity securities to file with the SEC initial reports of ownership and reports of changes in beneficial ownership of our common stock and other equity securities. Directors, officers and holders of more than 10% of any class of our equity securities are required by SEC regulations to furnish us with all Section 16(a) forms they file.

To our knowledge, based solely upon our review of the copies of such reports furnished to us, we believe that all of our directors, officers and holders of more than 10% of any class of our equity securities have complied with the applicable Section 16(a) reporting requirements, except that one report of change in beneficial ownership, covering one transaction, was not filed by Ilan Biran.

Code of Conduct and Ethics

On March 25, 2004, we adopted a Corporate Code of Conduct and Ethics applicable to all employees and directors of deltathree, including our principal executive officer, principal financial and accounting officer and controller. There were no changes made to the Corporate Code of Conduct and Ethics during 2007. The text of the Corporate Code of Conduct and Ethics is posted on the Corporate Governance section of our website at www.deltathree.com and will be made available to stockholders without charge, upon request, in writing to the Secretary at 75 Broad Street, New York, New York 10004. We intend to post on our website and include in a Current Report on Form 8-K filed with the SEC any amendments to, or waivers from, our Code of Conduct and Ethics that apply to our principal executive officer, principal financial and accounting officer and controller. We have all of our new employees certify that they have read and understand our Corporate Code of Conduct and Ethics, and, periodically, we also ask our existing employees to certify that they have reviewed our Corporate Code of Conduct and Ethics.

ITEM 11. EXECUTIVE COMPENSATION

Summary Compensation Table

The following table shows the total compensation paid or accrued during the fiscal year ended 2007 to (1) our Chief Executive Officer (principal executive officer, principal financial officer, and principal accounting officer), and (2) our two next most highly compensated executive officers whose total compensation exceeded \$100,000 during the fiscal year ended 2007. The table includes one additional former executive who would have been among the three most highly compensated executive officers except for the fact that he was not serving as an executive officer of the Company as of the end of 2007. These executive officers are referred to in this Annual Report as our “named executive officers”.

<u>Name and Principal Position</u>	<u>Year</u>	<u>Salary (\$)</u>	<u>Bonus (\$)</u>	<u>Stock Awards (\$)</u>	<u>Option Awards (\$)</u>	<u>All Other Compensation (\$)</u>	<u>Total (\$)</u>
Shimmy Zimels, <i>Chief Executive Officer and President (principal executive officer, principal financial officer, and principal accounting officer)</i>	2007	258,005(1)	0	0	0	0	258,005
Guy Gussarsky (2), <i>Former Executive Vice President of Sales and Business Development</i>	2007	13,015(3)	0	0	0	0	13,015
Richard Grant, <i>Senior Vice President of Finance and Treasurer</i>	2007	175,000	0	0	0	0	175,000

- (1) Mr. Zimels was entitled to receive a base salary of \$264,971, but voluntarily waived his right to receive any additional salary for 2007. See “- *Employment Agreement with Mr. Shimmy Zimels*” below.
- (2) Mr. Gussarsky resigned effective as of February 14, 2007.
- (3) Includes both base and commission components of Mr. Gussarsky’s salary.

We currently have an employment agreement in place with Mr. Zimels, with the following principal terms:

- The agreement was effective from April 26, 2004 through August 31, 2006 and, thereafter, is automatically extended for the same duration on the expiration date and on each expiration date thereafter unless either party provides the other party with written notice of non-renewal at least ninety days prior to expiration of the then-current term, provided that Mr. Zimels provides notice of renewal to the Compensation Committee six months prior to expiration of the then-current term.
- Mr. Zimels' base salary is increased on each January 1 by an amount equal to the base salary then in effect, multiplied by the applicable cost of living index during the prior year. Mr. Zimels was entitled to receive a base salary of \$264,971 during 2007, which represented an increase of \$6,966 from his base salary 2006, but voluntarily waived his right to receive the additional amounts; likewise, in 2008, Mr. Zimels was entitled to receive a base salary of \$274,775, which represented an increase of \$9,804 from the base salary he was entitled to receive in 2007, but voluntarily waived his right to receive any amounts in addition to his base salary for 2006. The employee's base salary, as adjusted for cost of living increases, may be further increased at the option and in the discretion of our Board.
- For principal terms contained in Mr. Zimels' employment agreement pertaining to termination and change of control, see the subsection below titled "Termination of Employment and Change-in-Control Arrangements" in this Annual Report.

Outstanding Equity Awards at Fiscal Year-End

The following table shows grants of stock options and grants of unvested stock awards outstanding on December 31, 2007 to each of the named executive officers named in the Summary Compensation Table.

Name	Grant Date (1)	Option Awards			Stock Awards		
		Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)
Shimmy Zimels	12/31/2000	130,000		1.38	12/31/2008		
	3/16/2001	39,000		1.13	3/16/2008		
	3/12/2002	100,000		1.02	3/12/2009		
	11/4/2003	85,000		1.76	11/4/2010		
	12/22/2004	80,000		2.86	12/22/2014		
	7/31/2006					30,000(2)	37,800(3)
Guy Gussarsky(4)	7/31/2006					25,000	0
Richard Grant	1/23/2006	16,666	33,334(5)	3.02	1/23/2016		

- (1) For better understanding of this table, we have included an additional column showing the grant date of the stock options and the restricted shares of common stock.
- (2) Restricted shares of our common stock were granted on July 31, 2006 and vest as follows: 8,400 on the first anniversary of the grant date, 9,900 on the second anniversary of the grant date, and 11,700 on the third anniversary of the grant date, provided Mr. Zimels remains an employee of the Company on such date.
- (3) The market value of the stock awards is determined by multiplying the number of shares times \$0.401, the closing price of our common stock on The Nasdaq Capital Market on December 31, 2007, the last day of our fiscal year.
- (4) Mr. Gussarsky resigned effective as of February 14, 2007.
- (5) Options to purchase 16,666 shares of common stock vested on each of January 23, 2007, and January 23, 2008. The remaining options will vest on January 23, 2009.

Director Compensation

The following table shows the total compensation paid or accrued during the fiscal year ended 2007 to each of our directors.

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)(1)	All Other Compensation (\$)	Total (\$)
Noam Bardin	15,000	23,755(2)	0	38,755
Ilan Biran	15,000	18,796(3)	0	33,796
Benjamin Broder	15,000	15,336(4)	0	30,336
Lior Samuelson	15,000	15,336(5)	0	30,336
Shimmy Zimels (6)	0	0	0	0

- (1) See Note 2(p) and Note 9 to our audited consolidated financial statements included elsewhere in this Annual Report for details as to the assumptions used to determine the fair value of the stock awards.
- (2) Consists of \$4,496 and \$1,499 representing the compensation expense incurred by us in fiscal year 2007 in connection with the issuances of 18,000 and 6,000 restricted shares of our common stock on September 4, 2007 as the form of payment for board and chairman services and for services as a member of the audit committee, respectively, for the period from the 2007 annual stockholders' meeting though and until the company's next annual stockholders' meeting in 2008, calculated in accordance with SFAS 123R, all of which fully vest on September 4, 2008. The restricted share grants were made pursuant to the 2006 Non-Employee Director Stock Plan.
- (3) Represents the compensation expense incurred by us in fiscal year 2007 in connection with the issuance of 16,000 restricted shares of our common stock on September 4, 2007 as the form of payment for board and committee chairman services for the period from the 2007 annual stockholders' meeting though and until the company's next annual stockholders' meeting in 2008, calculated in accordance with SFAS 123R, all of which fully vest on September, 2008. The restricted share grants were made pursuant to the 2006 Non-Employee Director Stock Plan.
- (4) Represents the compensation expense incurred by us in fiscal year 2007 in connection with the issuance of 14,000 restricted shares of our common stock on September 4, 2007 as the form of payment for board and committee chairman services for the period from the 2007 annual stockholders' meeting though and until the company's next annual stockholders' meeting in 2008, calculated in accordance with SFAS 123R, all of which fully vest on September 4, 2008. The restricted share grants were made pursuant to the 2006 Non-Employee Director Stock Plan.
- (5) Represents the compensation expense incurred by us in fiscal year 2007 in connection with the issuance of 14,000 restricted shares of our common stock on September 4, 2007 as the form of payment for board and audit committee services for the period from the 2007 annual stockholders' meeting though and until the company's next annual stockholders' meeting in 2008, calculated in accordance with SFAS 123R, all of which fully vest on September 4, 2008. The restricted share grants were made pursuant to the 2006 Non-Employee Director Stock Plan.
- (6) Mr. Zimels is a management director, who is not entitled to any fees or awards other than the compensation he receives as our Chief Executive Officer and President. See "Executive Compensation - Summary Compensation Table" in this Annual Report for further information.

Director Compensation Policy

At our Annual Meeting on September 4, 2007, each of our non-employee directors (Noam Bardin, Ilan Biran, Benjamin Broder, and Lior Samuelson) became eligible to receive \$15,000 for their services as directors through the date of our next Annual Meeting. In this regard, we paid \$15,000 to each non-employee director in 2007. Directors are reimbursed for the expenses they incur in attending meetings of the Board and Board committees.

We reimburse each member of our Board of Directors who is not an employee for reasonable travel and other expenses in connection with attending meetings of the Board of Directors.

Prior to our Annual Meeting on September 8, 2006, our non-employee directors also received grants of stock options pursuant to our 2004 Non-Employee Director Stock Option Plan. This option plan is described below. At our 2006 Annual Meeting, our stockholders approved, based on our Board's recommendation, the 2006 Non-Employee Director Stock Plan. The 2006 Non-Employee Director Stock Plan replaced our 2004 Non-Employee Director Stock Option Plan which was terminated, except with respect to outstanding options previously granted thereunder. The 2006 Non-Employee Director Stock Plan is described below.

2004 Non-Employee Director Stock Option Plan

The purposes of the 2004 Non-Employee Director Stock Option Plan, as amended, or the Director Plan, are to enable us to attract, maintain and motivate qualified directors and to enhance a long-term mutuality of interest between our directors and shareholders of our common stock by granting our directors options to purchase our shares.

The Director Plan provides for the automatic grant of nonstatutory stock options. Options granted under the Plan are not intended to qualify as “incentive stock options” within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, or the Code. The aggregate number of shares of common stock that may be issued under the Director Plan shall not exceed (a) 851,216 shares, plus (b) such additional shares of common stock as are represented by Options previously granted under the 1999 Directors Plan which are cancelled or expire after the date of stockholder approval of the Director Plan without delivery of shares of stock by the Company.

Initial Option Awards. Each director who is not an employee of the Company will be granted options to acquire 10,000 shares of common stock on the date he or she joins the Board.

Subsequent Option Awards. On the first business day after each annual meeting of stockholders of the Company occurring during the term of the Plan, each non-employee director who meets the guidelines for Board service and who continues to be a non-employee director following such annual meeting shall automatically be granted an option to purchase 10,000 shares of common stock; provided that no Subsequent Option Award shall be made to any non-employee director who has not served as a director of the Company, as of the time of such annual meeting, for at least six months.

Committee Chairman Awards. Each non-employee director who is appointed as chairman of a standing committee of the Board (and has not served as the chairman of such committee immediately prior to the appointment) shall be automatically granted an option to purchase 10,000 shares of common stock on the date of such appointment. Each non-employee director who serves as a chairman of the full Board or of a standing committee of the Board other than the audit committee, and who meets the guidelines for Board service, immediately following each annual meeting of the Company’s stockholders, shall be granted an option to purchase an additional 10,000 shares of common stock; provided that no Committee Chairman Award shall be made to any non-employee director who has not served as a director of the Company, as of the time of such annual meeting, for at least six months, and no Committee Chairman Award shall be made to any Eligible Director who has received a Committee Chairman award for such service on the same committee within the past six months.

Audit Committee Service Awards. Each non-employee director who is appointed as a member of the audit committee of the Board (and has not served as a member of such committee immediately prior to that appointment) shall be automatically granted an option to purchase 10,000 shares of common stock on the date of such appointment. Each non-employee director who serves as a member of the audit committee of the Board, and who meets the guidelines for Board service, immediately following each annual meeting of the Company’s stockholders, shall be granted an option to purchase an additional 10,000 shares of common stock; provided that no Audit Committee Service Award shall be made to any non-employee director who has not served as a director of the Company, as of the time of such annual meeting, for at least six months, and no Audit Committee Award shall be made to any Eligible Director who has received an Audit Committee award for such service within the past six months. In addition, the chairman of the audit committee of the Board shall be granted an additional option to purchase 5,000 shares of common stock.

Notwithstanding the foregoing, a non-employee director shall receive a maximum number of options to purchase 30,000 shares of common stock during any single calendar year. The exercise price per share of common stock of each option granted pursuant to the Plan shall be equal to the fair market value per share on the date of grant. If not previously exercised, each option shall expire on the earlier of (i) the tenth anniversary of the date of the grant thereof and (ii) on the first anniversary of the termination of the non-employee director’s status as a director of the Company. Each option granted under the Plan shall become fully vested and exercisable on the first anniversary of the date of grant. In addition, options granted pursuant to the Plan will become exercisable in full upon a “change in control” as defined in the Plan. The Plan terminates at the close of business on September 23, 2014, unless sooner terminated by action of the Board or stockholders of the Company.

2006 Non-Employee Director Stock Plan

The purposes of the 2006 Stock Plan are to enable us to attract, maintain and motivate qualified directors and to enhance a long-term mutuality of interest between our directors and stockholders of our common stock by granting our directors restricted stock.

General. The 2006 Stock Plan provides for the automatic grant of restricted stock. The aggregate number of shares of restricted stock that may be issued under the 2006 Stock Plan shall be 500,000 shares. A grant of restricted stock is a grant of shares of our common stock that, at the time of issuance, are subject to certain forfeiture provisions, and thus are restricted as to transferability until such forfeiture restrictions have lapsed. The restrictions on the restricted stock issued pursuant to the Plan relate to continued service on the company’s board of directors (lapsing on a monthly basis). If we reacquire (at not more than its original issuance price) any shares of restricted stock or if any shares of restricted stock are forfeited, or otherwise cancelled or terminated, such shares which were subject to such restricted stock award shall again be available for issuance from time to time pursuant to the 2006 Stock Plan.

Except to the extent restricted under the terms of the 2006 Stock Plan, a non-employee director granted a restricted stock award will have the right to receive dividends or any other distributions paid with respect to those shares. During the restricted period (i.e., prior to the lapse of applicable forfeiture provisions), the restricted stock generally may not be sold, transferred, pledged, hypothecated, margined, or otherwise encumbered by the non-employee director.

Administration. The 2006 Stock Plan is administered by the Board. The Board may delegate its powers and functions hereunder to a duly appointed committee of the Board. The Board shall have full authority to interpret the Plan; to establish, amend and rescind rules for carrying out the Plan; to administer the Plan; to incorporate in any option agreement such terms and conditions, not inconsistent with the Plan, as it deems appropriate; to construe the respective restricted stock agreements and the Plan; and to make all other determinations and to take such steps in connection with the Plan as the Board, in its discretion, deems necessary or desirable for administering the Plan.

Non-Discretionary Grants:

Initial Restricted Stock Awards. Each director who is not an employee of the Company will be granted 8,000 shares of restricted stock on the date he or she joins the Board.

Subsequent Restricted Stock Awards. On the first business day after each annual meeting of stockholders of the Company occurring during the term of the Plan commencing with the Meeting, each non-employee director who meets the guidelines for Board service and who continues to be a non-employee director following such annual meeting shall automatically be granted 8,000 shares of restricted stock; provided that no Subsequent Restricted Stock Award shall be made to any non-employee director who has not served as a director of the Company, as of the time of such annual meeting, for at least six months.

Committee Chairman Awards. Each non-employee director who is appointed as chairman of a standing committee of the Board (and has not served as the chairman of such committee immediately prior to the appointment) shall be automatically granted 6,000 shares of restricted stock on the date of such appointment. Each non-employee director who serves as a chairman of the full Board or of a standing committee of the Board other than the audit committee, and who meets the guidelines for Board service, immediately following each annual meeting of the Company's stockholders, commencing with the Meeting, shall be granted an additional 6,000 shares of restricted stock; provided that no Committee Chairman Award shall be made to: any non-employee director who has not served as a director of the Company, as of the time of such annual meeting, for at least six months, and no Committee Chairman Award shall be made to any Eligible Director who has received a Committee Chairman award for such service on the same committee within the past six months.

Audit Committee Service Awards. Each non-employee director who is appointed as a member of the audit committee of the Board (and has not served as a member of such committee immediately prior to that appointment) shall be automatically granted 6,000 shares of restricted stock on the date of such appointment. Each non-employee director who serves as a member of the audit committee of the Board, and who meets the guidelines for Board service, immediately following each annual meeting of the Company's stockholders, commencing with the Meeting, shall be granted an additional 6,000 shares of restricted stock; provided that no Audit Committee Service Award shall be made to any non-employee director who has not served as a director of the Company, as of the time of such annual meeting, for at least six months, and no Audit Committee Award shall be made to any Eligible Director who has received an Audit Committee award for such service within the past six months. In addition, the chairman of the audit committee of the Board shall be granted an additional 2,000 shares of restricted stock.

Annual Limitation. There is no annual limitation on the maximum number of shares of restricted stock to be granted to a non-employee director during any single calendar year.

Forfeiture. Each share of restricted stock under the Plan shall become fully vested and nonforfeitable upon the first anniversary of the date of grant. If a non-employee director ceases to serve as a member of the Board for any reason (including, resignation, failure to stand for re-election or failure to be re-elected), any award of restricted stock shall become vested and nonforfeitable as to that number of shares which is equal to the number of shares of common stock subject to such award times a fraction, the numerator of which is the number of days actually served as a director during the restricted period and the denominator of which is the total number of days during the restricted period. Any portion of any restricted stock that has not become nonforfeitable at the date of a non-employee director's termination of service shall be forfeited as of such date.

Change in Control. Notwithstanding anything to the contrary in the Plan, shares of restricted stock granted pursuant to the Plan will become fully vested and nonforfeitable in full upon a "change in control." A "change in control" shall arise if, at any time while the non-employee director is a member of the Company's Board any one or more of the following events occurs:

(i) The Company is merged, consolidated or reorganized into or with another corporation, or other entity and, as a result thereof, less than 50% of the outstanding stock or other capital interests of the surviving, resulting or acquiring corporation, person, or other entity is owned, in the aggregate, by the stockholder or stockholders of the Company immediately prior to such merger, consolidation or reorganization;

(ii) The Company sells all or substantially all of its business or assets (or both) to any other corporation, person, or other entity, less than 50% of the outstanding, voting stock or other capital interests of which are owned, in the aggregate, by the stockholders of the Company, directly or indirectly, immediately prior to or after such sale; or

(iii) Any “Person” (as such term is used in Sections 13(d) and 14(d) of the Exchange Act) other than a Person who is an affiliate as of the effective date of the Plan becomes the “Beneficial Owner” (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 50% or more of the total voting power represented by the Company’s then outstanding voting securities (excluding for this purpose the Company or its affiliates or any employee benefit plan of the Company) pursuant to a transaction or a series of related transactions which the Board of Directors does not approve.

Transferability of Awards. No shares of restricted stock under the Plan shall be transferable by the non-employee otherwise than by will or under the applicable laws of descent and distribution, unless such transfer shall be (a) acceptable under Rule 16b-3 and is approved by the Board or its authorized delegate or (b) if the restricted stock agreement pursuant to which the restricted stock grant is made so provides, by gift or domestic relations order, to (i) the spouse, children or grandchildren of such non-employee director (collectively, “Family Members”), (ii) a trust or trusts for the exclusive benefit of such Family Members, or (iii) a partnership or limited liability company in which such Family Members and trusts for the exclusive benefit of such Family Members are the only partners or members, as the case may be.

Termination and Amendment. This Plan shall terminate at the close of business on September 23, 2014, unless sooner terminated by action of the Board or stockholders of the Company. The Board at any time or from time to time may amend this Plan to effect (i) amendments necessary or desirable in order that this Plan and the options granted thereunder shall conform to all applicable laws and regulations and (ii) any other amendments deemed appropriate. Notwithstanding the foregoing, (i) the provisions of the Plan relating to (A) the number of shares to be granted under the Plan or subject to any restricted stock award granted to any non-employee director, (B) the timing of any restricted stock grant and (C) the material terms of the restricted stock (including, without limitation, the time of any such grant) may not be amended without the approval of the Company's stockholders and (ii) the Board may not effect any amendment that would require the approval of the stockholders of the Company under any applicable laws or the listing requirements of the Nasdaq Stock Market (if applicable to the Company at the time such amendment is adopted or will be effective) unless such approval is obtained.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information with respect to the beneficial ownership of shares of our common stock as of January 31, 2008 by:

- each person whom we know beneficially owns more than 5% of our common stock;
- each of our directors individually;
- each of our named executive officers individually; and
- all of our directors and executive officers as a group.

Unless otherwise indicated, to our knowledge, all persons listed below have sole voting and investment power with respect to their shares of common stock. Each person listed below disclaims beneficial ownership of their shares, except to the extent of their pecuniary interests therein. Shares of common stock that an individual or group has the right to acquire within 60 days of January 31, 2008 pursuant to the exercise of options are deemed to be outstanding for the purpose of computing the percentage ownership of such person or group, but are not deemed outstanding for the purpose of calculating the percentage owned by any other person listed.

	<u>Number</u>	<u>Percentage(1)</u>
	<u>Shares of deltatathree Class A Common Stock Beneficially Owned</u>	
Principal Stockholder:		
Atarey Hasharon Chevra Lepituach Vehashkaot Benadlan (1991) Ltd. 7 Giborey Israel St., P.O. Box 8468 South Netanya Industrial Zone 42504, Israel	11,927,677	36.3%
Executive Officers and Directors:		
Noam Bardin(2)(3)(9)	588,366	1.8%
Shimmy Zimels(2)(4)	528,469	1.6%
Ilan Biran (2)(5)(9)	105,849	*
Benjamin Broder (2)(6)(9)	42,000	*
Lior Samuelson (2)(7)(9)	82,000	*
Richard Grant (2)(8)	50,000	*
All Directors and Executive Officers as a group (6 persons) (10)	1,396,684	4.1%

* Less than 1%.

- (1) Percentage of beneficial ownership is based on 32,870,105 shares of common stock outstanding as of January 31, 2008.
- (2) The address for the director or executive officer listed is c/o the Company.
- (3) Includes (a) 187,366 shares of common stock, (b) options to purchase 365,000 shares of common stock and (c) 36,000 restricted shares of common stock.
- (4) Includes (a) 64,469 shares of common stock, (b) options to purchase 434,000 shares of common stock and (c) 30,000 restricted shares of common stock.
- (5) Includes (a) options to purchase 89,849 shares of common stock and (b) 16,000 restricted shares of common stock.
- (6) Includes (a) options to purchase 20,000 shares of common stock and (b) 22,000 restricted shares of common stock.
- (7) Includes (a) options to purchase 60,000 shares of common stock and (b) 22,000 restricted shares of common stock.
- (8) Includes options to purchase 50,000 shares of common stock.
- (9) All restricted share grants to our non-employee directors fully vest and are not subject to forfeiture upon the first anniversary of the date of grant, provided the individual is serving as a director upon such date. The grants are subject to partial vesting in the event the director no longer serves as a director upon the first anniversary date.
- (10)

Includes (a) 251,835 shares of common stock, (b) options to purchase 1,018,849 shares of common stock and (c) 126,000 restricted shares of our common stock.

Equity Compensation Plan Information

The following table provides certain aggregate information with respect to shares of our common stock that may be issued under our equity compensation plans in effect as of December 31, 2007.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights(1)	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in first column)(2)
Equity Compensation Plans Approved by Security Holders (3)	1,560,020	\$ 1.91	3,337,875
Equity Compensation Plans not Approved by Security Holders	N/A	N/A	N/A
Total	1,560,020	\$ 1.91	3,337,875

- (1) Does not include 178,540 restricted shares of our common stock that had been granted under our equity compensation plans as of December 31, 2007.
- (2) During the first quarter of 2008, we issued to our employees under our 2004 Stock Incentive Plan restricted units to acquire 240,000 shares of our common stock and options to acquire approximately 1,400,000 shares of our common stock.
- (3) These plans consist of our 2004 Stock Incentive Plan and 2006 Non-Employee Director Stock Plan. The table also includes information for our 1999 Directors' Plan and our 1999 Employee Stock Incentive Plan, both of which have expired. Additionally, our 2004 Non-Employee Director Stock Option Plan was terminated, except with respect to outstanding options previously granted thereunder.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

We are not, and have not been during the last two fiscal years, a party to any related-party transactions. All transactions between us and our officers, directors, principal stockholders and affiliates must be reviewed and approved in advance by the Audit Committee.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The following table presents fees for professional audit services rendered by Brightman Almagor & Co. for the audit of the Company's annual financial statements for the years ended December 31, 2007, and December 31, 2006, and fees billed for other services rendered by Brightman Almagor & Co. during those periods.

	2007	2006
Audit fees	\$ 65,000	\$ 62,500
Audit related fees	-	-
Tax fees	16,500	18,500
All other fees	-	-
Total	<u>\$ 81,500</u>	<u>\$ 81,000</u>

In the above table, in accordance with the SEC's definitions and rules, "audit fees" are fees we paid Brightman Almagor & Co. for professional services for the audit of our annual financial statements and review of financial statements included in our quarterly reports filed with the SEC, as well as for work generally only the independent auditor can reasonably be expected to provide, such as statutory audits and consultation regarding financial accounting and/or reporting standards; "audit-related fees" are fees billed by Brightman Almagor & Co. for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements; "tax fees" are fees for tax compliance, tax advice and tax planning; and "all other fees" are fees billed by Brightman Almagor & Co for any services not included in the first three categories.

Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors

Consistent with SEC policies regarding auditor independence, the Audit Committee has responsibility for appointing, setting compensation and overseeing the work of the independent auditor. In recognition of this responsibility, the Audit Committee has established a policy to pre-approve all audit and permissible non-audit services provided by the independent auditor.

Prior to engagement of the independent auditor for the next year's audit, management will submit an aggregate of services expected to be rendered during that year for each of four categories of services to the Audit Committee for approval.

1. **Audit** services include audit work performed in the preparation of financial statements, as well as work that generally only the independent auditor can reasonably be expected to provide, including comfort letters, statutory audits, and attest services and consultation regarding financial accounting and/or reporting standards.

2. **Audit-Related** services are for assurance and related services that are traditionally performed by the independent auditor, including due diligence related to mergers and acquisitions, employee benefit plan audits, and special procedures required to meet certain regulatory requirements.

3. **Tax** services include all services performed by the independent auditor's tax personnel except those services specifically related to the audit of the financial statements, and includes fees in the areas of tax compliance, tax planning, and tax advice.

4. **Other** services are those associated with services not captured in the other categories. The Company generally does not request such services from the independent auditor.

Prior to engagement, the Audit Committee pre-approves these services by category of service. The fees are budgeted and the Audit Committee requires the independent auditor and management to report actual fees versus the budget periodically throughout the year by category of service. During the year, circumstances may arise when it may become necessary to engage the independent auditor for additional services not contemplated in the original pre-approval. In those instances, the Audit Committee requires specific pre-approval before engaging the independent auditor.

The Audit Committee may delegate pre-approval authority to one or more of its members. The member to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements.

The Consolidated Financial Statements filed as part of this Annual Report are identified in the Index to Consolidated Financial Statements on page F-1 hereto.

(a)(2) Financial Statement Schedules.

Financial Statement Schedules have been omitted because the information required to be set forth therein is not applicable or is shown on the financial statements or notes thereto.

(a)(3) Exhibits.

The following exhibits are filed herewith or are incorporated by reference to exhibits previously filed with the SEC.

Exhibit Number	Description
2.1	Asset Transfer Agreement dated February 17, 2007 by and between deltathree, Inc. and Go2Call.com, Inc. (Incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K, filed on February 20, 2007).
3.1.1	Form of Restated Certificate of Incorporation of deltathree, Inc. (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
3.1.2	Form of Amendment to Restated Certificate of Incorporation of deltathree, Inc. (Incorporated by reference to our Annual Report on Form 10-K/A, filed on April 30, 2001).
3.2	Form of Amended and Restated By-laws of deltathree, Inc. (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
4.1	Specimen Certificate of Class A Common Stock (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
4.2	Specimen Certificate of Class B Common Stock (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
10.1	Form of deltathree, Inc. 1999 Stock Incentive Plan (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).+
10.2	Form of deltathree, Inc. 1999 Employee Stock Purchase Plan (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
10.3	Form of deltathree, Inc. 1999 Performance Incentive Plan (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).+
10.4	Form of deltathree, Inc. 1999 Directors' Plan (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).+
10.5	Employment Agreement, effective as of April 26, 2004, between Shimmy Zimels and deltathree, Inc. (Incorporated by reference to our Annual Report on Form 10-K/A, filed on April 29, 2004).+

- 10.6 2004 Stock Incentive Plan (Incorporated by reference to our registration statement on Form S-8 (Registration No. 333-86503)).+
- 10.7 2004 Non-Employee Director Stock Option Plan (Incorporated by reference to our registration statement on Form S-8 (Registration No. 333-86503)).+
- 10.8 Form of Option Agreement Pursuant to 2004 Stock Incentive Plan (Incorporated by reference to our Annual Report on Form 10-K, filed on March 31, 2005).+
- 10.9 Form of Option Agreement Pursuant to 2004 Non-Employee Director Stock Option Plan (Incorporated by reference to our Annual Report on Form 10-K, filed on March 31, 2005).+
- 10.10 Executive and Director Compensation Arrangements (Incorporated by reference to our Annual Report on Form 10-K, filed on March 31, 2005).+
- 10.11 First Amendment to the deltathree, Inc. 2004 Stock Incentive Plan, dated as of December 20, 2005 (Incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K, filed on December 21, 2005).+
- 10.12 First Amendment to the deltathree, Inc. 2004 Non-Employee Director Stock Option Plan, dated as of December 20, 2005 (Incorporated by reference to Exhibit 10.2 of our Current Report on Form 8-K, filed on December 21, 2005).+
- 10.13 Registration Rights Agreement dated February 19, 2007 by and between deltathree, Inc. and Go2Call.com, Inc. (Incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K, filed on February 20, 2007).
- 10.14 deltathree, Inc. Amended and Restated 1999 Performance Incentive Plan (Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K, filed on July 11, 2006).+
- 10.15 Deltathree, Inc. 2006 Non-Employee Director Stock Plan (Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K, filed on September 8, 2006).+
- 10.16* Form of Restricted Unit Agreement Pursuant to 2004 Stock Incentive Plan.+
- 10.17 Employment Agreement, dated as of February 1, 2008, between Lior Samuelson and deltathree, Inc. (Incorporated by reference to our Current Report on Form 8-K, filed on February 4, 2008).+
- 14.1 deltathree, Inc. Corporate Code of Conduct and Ethics (Incorporated by reference to our Annual Report on Form 10-K, filed on March 30, 2004).
- 21.1* Subsidiaries of deltathree, Inc.
- 23.1* Consent of Brightman Almagor & Co.
- 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* Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

+ Management contract or compensatory plan.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board and Stockholders of
deltathree, Inc.

We have audited the accompanying consolidated balance sheets of deltathree, Inc. ("the Company") and its subsidiary as of December 31, 2007 and 2006 and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiary as of December 31, 2007 and 2006, and the consolidated results of its operations and its consolidated cash flows for each of the three years in the period ended December 31, 2007 in conformity with U.S. generally accepted accounting principles.

/s/Brightman Almagor & Co.
Certified Public Accountants
A member firm of Deloitte Touche Tohmatsu

Tel Aviv, Israel
March 27, 2008

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

	December 31,	
	2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,649	\$ 3,790
Restricted cash and short-term investments (Note 3)	5,883	12,067
Accounts receivable, net (Note 4)	1,061	1,286
Prepaid expenses and other current assets (Note 5)	526	444
Inventory	193	155
Total current assets	9,312	17,742
Restricted cash and long-term investments (Note 3)	1,085	1,085
Property and equipment:		
Telecommunications equipment	18,219	18,147
Furniture, fixtures and other	679	639
Leasehold improvements	4,870	4,677
Capital leases	225	-
Computers hardware & software	8,946	8,474
	<u>32,939</u>	<u>31,937</u>
Less accumulated depreciation	<u>(30,057)</u>	<u>(28,479)</u>
Property and equipment, net	2,882	3,458
Goodwill, net	2,002	-
Other intangible assets, net	1,902	-
	<u>116</u>	<u>110</u>
Deposits	116	110
Total assets	\$ 17,299	\$ 22,395
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of capital leases (Note 7)	\$ 69	
Accounts payable	2,505	\$ 2,916
Deferred revenues	551	1,099
Other current liabilities (Note 6)	1,665	1,545
Total current liabilities	4,790	5,560
Long-term liabilities:		
Capital leases - net of current portion (Note 7)	144	-
Severance pay obligations (Note 8)	341	217
Total current liabilities	485	217
Total liabilities	5,275	5,777
Commitments and contingencies (Note 9)		
Stockholders' equity (Note 10):		
Share capital		
Class A Common stock, - par value \$0.001; authorized 75,000,000 shares;		
issued and outstanding: 32,870,105 at December 31, 2007;		
29,808,214 at December 31, 2006		
	33	30
Additional paid-in capital	172,747	168,030
Accumulated deficit	(160,756)	(151,442)
Total stockholder's equity	12,024	16,618
Total liabilities and stockholder's equity	\$ 17,299	\$ 22,395

The accompanying notes are an integral part of these consolidated financial statements.

DELTATHREE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(\$ in thousands, except share data)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Revenues (Note 13):	\$ 29,477	\$ 37,953	\$ 29,714
Costs and operating expenses:			
Cost of revenues (exclusive of \$599, \$615 and \$822 depreciation included in a separate line below, respectively)	21,107	24,375	18,698
Research and development expenses (Note 11)	4,669	4,043	3,228
Selling and marketing expenses	5,068	4,956	4,173
General and administrative expenses	2,952	3,088	2,912
Write down of intangible asset	2,680	-	-
Depreciation and amortization	<u>2,644</u>	<u>1,543</u>	<u>1,931</u>
Total costs and operating expenses	<u>39,120</u>	<u>38,005</u>	<u>30,942</u>
Loss from operations	(9,643)	(52)	(1,228)
Other non operating income	13	-	-
Interest income, net	<u>442</u>	<u>620</u>	<u>418</u>
Loss before income taxes	(9,188)	568	(810)
Income taxes (Note 12)	<u>126</u>	<u>61</u>	<u>44</u>
Net loss	<u>\$ (9,314)</u>	<u>\$ 507</u>	<u>\$ (854)</u>
Net loss per share-basic and diluted	<u>\$ (0.29)</u>	<u>\$ 0.02</u>	<u>\$ (0.03)</u>
Basic weighted average number of shares outstanding	<u>32,427,118</u>	<u>29,771,470</u>	<u>29,671,820</u>
Diluted weighted average number of shares outstanding	<u>32,427,118</u>	<u>30,129,011</u>	<u>29,671,820</u>

The accompanying notes are an integral part of these consolidated financial statements.

DELTATHREE, INC.
STATEMENTS OF STOCKHOLDER'S EQUITY
(\$ in thousands, except share data)

	<u>Class A Common Stock</u>			<u>Additional Paid-in Capital</u>	<u>Treasury Stock (at Cost)</u>	<u>Accumulated Deficit</u>	<u>Total Stockholders' Equity</u>
	<u>Number of Outstanding Shares</u>	<u>Number of Treasury Shares</u>	<u>Amount</u>				
Balance at January 1, 2005	29,381,313	257,600	29	167,301	(210)	(151,095)	16,025
Exercise of employee options	357,919		1	389			390
Loss for the year						(854)	(854)
Balance at December 31, 2005	29,739,232	257,600	30	167,690	(210)	(151,949)	15,561
Cancellation of treasury stock		(257,600)		(210)	210		-
Exercise of employee options	68,982		—*	550			550
Loss for the year						507	507
Balance at December 31, 2006	29,808,214	-	30	168,030	-	(151,442)	16,618
Go2Call acquisition	2,959,831		3	4,200			4,203
Exercise of employee options	35,000		—*	32			32
Vesting of restricted shares	67,060		—*				
Share based compensation				485			485
Loss for the year						(9,314)	(9,314)
Balance at December 31, 2007	<u>32,870,105</u>	<u>-</u>	<u>\$ 33</u>	<u>\$ 172,747</u>	<u>\$ -</u>	<u>\$ (160,756)</u>	<u>\$ 12,024</u>

* Less than \$1 thousand.

The accompanying notes are an integral part of these consolidated financial statements.

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

	Year ended December 31,		
	2007	2006	2005
Cash flows from operating activities:			
Net (loss) income	\$ (9,314)	\$ 507	\$ (854)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities			
Write down for intangible asset	2,680	-	-
Depreciation and amortization	1,576	1,543	1,931
Amortization of intangible asset	1,068	-	-
Stock based compensation	485	480	-
Capital gain, net	-	(1)	-
Liability for severance pay, net	124	62	51
Provision for losses on accounts receivable	110	25	-
Exchange rates differences on deposits, net	(6)	-	-
Changes in operating assets and liabilities:			
Decrease (Increase) in accounts receivable	115	(608)	(378)
(Increase) decrease in prepaid expenses other current assets	(82)	168	(84)
(Increase) decrease in inventory	(38)	87	(49)
(Decrease) increase in accounts payable	(778)	(988)	203
(Decrease) increase in deferred revenues	(1,172)	755	(109)
Increase (decrease) in other current liabilities	120	5	(494)
	4,202	1,528	1,071
Net cash (used in) provided by operating activities	(5,112)	2,035	217
Cash flows from investing activities:			
Purchase of property and equipment	(724)	(883)	(1,376)
Proceeds from sale of property and equipment	-	14	-
Long term investment, net	-	131	(121)
Decrease (increase) in short-term investments	6,184	(1,419)	(121)
Purchase of Go2Call operations, net	(2,509)	-	-
Net change in deposits	-	(5)	2
Net cash provided by (used in) investing activities	2,951	(2,162)	(1,616)
Cash flows from financing activities:			
Payment of capital leases	(12)	-	-
Proceeds from exercise of employee options	32	70	390
Net cash provided by financing activities	20	70	390
(Decrease) increase in cash and cash equivalents	(2,141)	(57)	(1,009)
Cash and cash equivalents at beginning of year	3,790	3,847	4,856
Cash and cash equivalents at end of year	1,649	3,790	3,847

Supplemental disclosures of cash flow information:

Cash paid for:			
Taxes	108	68	21

Supplemental schedule of non cash investing and financing activities:

Acquisition of fixed assets on credit	-	-	44
Acquisition of capital leases	225	-	-
Cancellation of treasury stock	-	210	-

Supplemental schedule of acquisition of Go2Call

Fixed assets	\$ 51
Goodwill	\$ 2,002
Intangible asset	\$ 5,650
Accounts payable	\$ (367)

Deferred revenues	\$ (624)
Stock issuance	\$ (4,203)
Total	<u>\$ 2,509</u>

The accompanying notes are an integral part of these consolidated financial statements.

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DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - The Company

deltathree, Inc. (the "Company"), a Delaware corporation, is a global provider of integrated Voice over Internet Protocol (VoIP) telephony services. The Company was founded in 1996 to capitalize on the growth of the Internet as a communication tool by commercially offering Internet Protocol (IP) telephony services. IP telephony is the real time transmission of voice communications in the form of digitized "packets" of information over the public Internet or a private network, similar to the way in which e-mail and other data is transmitted. The Company's business currently includes the transmission of voice and data traffic for communications carriers, the provision of enhanced Web-based and other communications services to individual consumers and the provision of a total "Hosted Consumer VoIP Solution" that enables corporate customers and service providers to offer private label telecommunications to their customer bases.

Prior to the end of the first quarter of 2008, the Company initiated a process of attempting to realign its cost structure with its current business model and began to reduce its operations and expenses (including a significant reduction in work force) in order to immediately reduce its cash burn rate. In addition, with the assistance of outside strategic consultants the Company began the process of examining ways to possibly increase its current revenues by growing its current sales and/or entering into new sales channels.

Note 2 - Summary of significant accounting policies

a. Basis of presentation

The financial statements have been prepared in conformity with U.S. generally accepted accounting principles.

b. Principles of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary. All significant inter-company accounts and transactions have been eliminated.

c. Financial statements in U.S. dollars

The reporting currency of the Company is the U.S. dollar ("dollar"). The dollar is the functional currency of the Company and its subsidiary. Transactions and balances originally denominated in dollars are presented at their original amounts. Non-dollar transactions and balances are re-measured into dollars in accordance with the principles set forth in Statement of Financial Accounting Standards ("SFAS") No. 52. All exchange gains and losses from translation of monetary balance sheet items resulting from transactions in non-dollar currencies are recorded in the statement of operations as they arise.

d. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported and disclosed in the consolidated financial statement and the accompanying notes. Actual results could differ from those estimates

On an ongoing basis, the company evaluates its estimates, including those related to allowances for doubtful accounts receivable, the amortization of deferred revenue associated with customer accounts, the useful lives of property and equipment and the value of common stock, common stock options, and restricted stock for the purpose of determining stock-based compensation. The Company bases its estimates on historical experience, available market information, appropriate valuation methodologies, including the Black and Scholes option model and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

e. Cash and cash equivalents

The Company maintains cash with investment grade financial institutions. Cash equivalents consist of short-term, highly liquid investments that are readily convertible into cash with original maturities of three months or less.

f. Restricted Cash

Restricted cash represents amounts held in certificates of deposit and money market funds to support stand-by-letters of credit used as security for third party vendors.

g. Marketable securities

The Company accounts for its investments in marketable securities using SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). Management determines the appropriate classification of its investments in marketable securities at the time of purchase and reevaluates such determinations at each balance sheet date. Securities for which the Company does not have the intent or ability to hold to maturity are classified as available-for-sale. Available-for-sale securities are stated at fair value, with the unrealized gains and losses reported as a separate component of shareholders' equity under accumulated other comprehensive gain or loss. The Company has not recorded any unrealized gains or losses to date.

h. Inventory

Inventory consists of the cost of customer equipment and is at the lower of cost (principally on a standard cost basis which approximates FIFO) or market.

i. Property and equipment

Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the depreciable assets, which range from two to five years. Leasehold improvements are amortized based on the straight-line method over the shorter of the term of the lease, or the estimated useful life of the improvements.

j. Long lived assets

The Company applies the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This statement requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

k. Impairment of Goodwill and Intangible Asset

The Company evaluates its long-lived tangible and intangible assets for impairment in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," and SFAS No.144, "Accounting for the Impairment or Disposal of Long-Lived Assets," whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Goodwill is subject to an annual test for impairment. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2007, the Company amortized \$2,680,000 from the asset's book value.

l. Revenue recognition

The Company recognizes revenues from Internet telephony services based on minutes (or fractions thereof) of customer usage. The Company records payments received in advance for prepaid services and services to be supplied under contractual agreements as deferred revenue until such related services are provided.

m. Cost of revenues

Cost of revenues consists primarily of direct costs that the Company pays to third parties in order to provide telephony services. These costs include access, transmission and interconnection charges that the Company pays to other access providers to terminate domestic and international phone calls on the public switched telephone network. In addition, these costs include the cost to lease phone numbers, to co-locate in other telephone companies' facilities. These costs also include taxes that the Company pays on telecommunications services from our suppliers.

n. Research and development expenses

Research and development expenses are expensed as incurred and consist primarily of payroll and facilities charges associated with the research and development of our current and future products.

o. Income taxes

The Company provides for income taxes using the liability approach defined by SFAS No. 109, Accounting for Income Taxes. Deferred tax assets and liabilities are recognized for the expected tax consequences between the tax bases of the assets and liabilities and their reported amounts. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized and are reversed at such time that realization is believed to be more likely than not.

p. Stock-based compensation

Prior to the adoption of Statement of Financial Accounting Standards No. 123(R) ("SFAS 123(R)"), the Company accounted for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and in accordance with FASB Interpretation No. 44. Pursuant to these accounting pronouncements, the Company recorded compensation for stock options granted to employees over the vesting period of the options based on the difference, if any, between the exercise price of the options and the market price of the underlying shares at that date. Deferred compensation is amortized to compensation expense over the vesting period of the options. In accordance with the modified prospective transition method that the Company used in adopting SFAS 123(R) as of January 1, 2006, the consolidated financial statements prior to 2006 have not been restated to reflect, and do not include, the possible impact of SFAS 123(R).

Had compensation cost for the Company's option plans been determined on the basis of the fair value at the grant dates in accordance with the provisions of SFAS No. 123 "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, the Company's pro forma net loss and pro forma basic and diluted net loss per share for 2005 would have been as follows:

	Year ended December 31, 2005
Pro forma net loss:	
Net loss for the year, as reported	\$ (854)
Add: stock-based compensation determined under SFAS 123	(367)
Pro forma net loss	\$ (1,221)
Net loss per share - basic and diluted:	
As reported	\$ (0.03)
Pro forma	\$ (0.04)

The following assumptions were used for the fiscal year 2005: dividend yield of 0.00% for all periods; risk-free interest rate of 4.0% and 3.2% respectively; an expected life of 3-years for all periods; a volatility rate of 78% and 87% respectively.

Because the determination of the fair value of all options granted includes an expected volatility factor and since additional option grants are expected to be made each year, the above pro forma disclosures are not representative of the pro forma effects of reported net income for future years.

q. Restricted shares

The Company has granted restricted shares to retain, reward and motivate those employees who are deemed critical to the future success of the Company. The restricted share plan has been approved by the Board of Directors. We record compensation expense associated with non-vested restricted shares that have been granted in accordance with SFAS No. 123(R). In accordance with the aforementioned statement, we calculate compensation expense on the date of grant (number of shares granted multiplied by the fair value of our common stock on the date of grant) and recognize this expense, adjusted for forfeitures, ratably over the applicable vesting period.

r. Net Income (loss) per share

Basic and diluted net income (loss) per share have been computed in accordance with SFAS No. 128, "Earnings Per Share", using the weighted average number of common stock outstanding. Diluted earnings per share give effect to all potential dilutive issuances of ordinary shares that were outstanding during the period. A total of 1,061,427 incremental shares were excluded from the calculation of diluted net loss per ordinary share for 2005.

s. Concentration of credit risk

The Company is subject to concentrations of credit risk, which consist principally of cash and cash equivalents, short-term investments and trade accounts receivable.

The Company maintains its cash balances at various financial institutions. The Company performs periodic evaluations of the relative credit standing of these institutions.

The majority of the Company's non-carrier customers prepay for their services. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends and other information.

t. Fair value of financial instruments

The financial instruments of the Company consist mainly of cash and cash equivalents, short-term investments, current accounts receivable, accounts payable and long-term liabilities. In view of their nature, the fair value of the financial instruments included in working capital of the Company is usually identical or close to their carrying amounts.

u. Derivatives

The Company applies the provisions of Statement of Financial Accounting Standard (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. The standard requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through the statement of operations. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings, or recognized in other comprehensive income (loss) until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company use of derivatives is immaterial.

v. Reclassification

Certain prior years' amounts have been reclassified in conformity with the current year's financial statements presentation.

w. Recently issued accounting standards

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing the recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by the Company in 2007. The adoption of FIN 48 did not have a material impact on the Company's consolidated results of operations and financial condition.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 provides guidance for using fair value to measure assets and liabilities. It also responds to investors' requests for expanded information about the extent to which companies' measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards required (or permit) assets or liabilities to be measured at fair value, and does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the effect that the adoption of SFAS 157 will have on its consolidated results of operations and financial condition and is not yet in a position to determine such effects.

In February 2007, the FASB issued FASB No. 159, The Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of FASB Statement No. 115. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions in FASB No. 159 are elective; however, the amendment to FASB No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. The fair value option established by FASB No. 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. FASB No. 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. The Company does not expect the adoption of FASB No. 159 to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued FASB 141(R), “Business Combinations”, of which the objective is to improve the relevance, representational faithfulness and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. The new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. FASB 141(R) is effective for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of FASB No. 141(R) to have a material impact on its consolidated financial statements.

Note 3 - Investment in marketable securities and deposits

As previously noted under Marketable Securities in Note 2, the Company concluded that it was appropriate to classify investments in Auction Rate Securities as short-term investments. Auction Rate Securities generally have long-term stated maturities; however, these investments have characteristics similar to short-term investments because at pre-determined intervals, generally every 7 to 90 days, there is a new auction process at which these securities are reset to current interest rates. The Company classifies all of its short-term investments as available-for-sale securities. As of March 27, 2008, the Company had approximately \$225,000 in auction rate securities that had not been liquidated. The following is a summary of our restricted cash and available-for-sale securities as of December 31, 2007 and 2008.

a. Restricted cash and short-term investments

Comprised as follows:

	December 31,	
	2007	2006
	(\$ in thousands)	
Restricted cash (money market funds)*	\$ 481	\$ 283
Auction rate securities	3,675	10,725
Bank deposits	1,727	1,059
	<u>5,883</u>	<u>12,067</u>

b. Restricted cash and long-term investments

Comprised as follows:

	December 31,	
	2007	2006
	(\$ in thousands)	
Restricted cash (money market funds)*	\$ 1,085	\$ 1,085
	<u>\$ 1,085</u>	<u>\$ 1,085</u>

* Restricted cash represents amounts held in certificates of deposit and money market funds to support stand-by letters of credit used as security for third party vendors.

Note 4 - Accounts receivable, net

Accounts receivable are stated net of an allowance for doubtful accounts of approximately \$110,000 and \$25,000 at December 31, 2007 and 2006, respectively.

Note 5 - Prepaid expenses and other current assets

Prepaid expenses and other current assets consist of the following:

	<u>December 31,</u>	
	<u>2007</u>	<u>2006</u>
	(\$ in thousands)	
Government of Israel (VAT refund and other)	\$ 74	\$ 39
Deposits with suppliers	61	60
Prepaid expenses	308	274
Other	83	71
Total prepaid expenses and other current assets	<u>\$ 526</u>	<u>\$ 444</u>

Note 6 - Other current liabilities

Other current liabilities consist of the following:

	<u>December 31,</u>	
	<u>2007</u>	<u>2006</u>
	(\$ in thousands)	
Accrued expenses	\$ 1,176	\$ 867
Employees and related expenses	427	616
Other	62	62
Total other current liabilities	<u>\$ 1,665</u>	<u>\$ 1,545</u>

Note 7 - Capital leases - net of current portion

During the fourth quarter of 2007 the Company entered into a number of non-cancelable capital leases from various suppliers that amounted to approximately \$225,000. The Company entered into such capital leases to obtain equipment for its new data site. Future minimum non-cancelable lease payments required after December 31, 2007 are as follows:

2008	\$	69
2009		76
2010		68
2011 and thereafter		-
Total capital leases	\$	<u>213</u>

Note 8 - Severance pay obligations

deltathree Ltd., the Company's Israeli subsidiary, is subject to certain Israeli law and labor agreements that determine the obligations of deltathree Ltd. to make severance payments to dismissed employees and to employees leaving the Company under certain other circumstances. The obligation for severance pay benefits, as determined by Israeli law, is based upon length of service and the employee's most recent salary. This obligation is partially funded through regular deposits made by deltathree, Ltd. into unaffiliated companies for managers' insurance policies. Amounts funded are controlled by the fund trustees and insurance companies and are not under the control and management of deltathree, Ltd.

Expenses (income) relating to employee termination benefits were \$19,942, \$11,860 and \$62,368 for the years ended December 31, 2007, 2006 and 2005, respectively.

The aggregate value of the insurance policies as of December 31, 2007 and 2006 was \$910,452 and \$920,843, respectively.

Note 9 - Commitments and contingencies

a. Lease commitments

The Company leases offices in New York City for the headquarters of its United States operation with an initial cost of approximately \$731,000, increasing annually to \$815,000 during the final year of the lease. The lease extends until July 2010 with an option to extend the lease for an additional five years.

On October 2003 the Company entered into a sub-lease agreement with a third party to sub-lease approximately thirty percent of the overall the New York office space. The annual sub-lease income in 2007 was approximately \$156,000, increasing annually to \$168,000 during the final year of the lease. The sub-lease extends until July 2010.

Rent expense, net was \$628,000, \$ 650,000 and 653,202 for the years ended December 31, 2007, 2006 and 2005, respectively.

In addition, on September 2005 the Israeli subsidiary signed an amendment to its lease agreement that extended the lease term through December 2009 and increased the total space in the Israel office by 250 square meters, bringing the aggregate office space to 1,290 square meters, at an annual cost of \$220,000. According to the terms of this amendment, the Israeli subsidiary has an option to further extend the term of the lease for an additional five years, ending in December 2014.

Rent expense, net was \$220,000, \$ 200,000 and \$209,000 for the years ended December 31, 2007, 2006 and 2005, respectively

b. Legal proceedings

On or about August 30, 2007, one of our vendors commenced an action in the Southern District of New York against us for breach of contract, copyright infringement, breach of the duty of good faith and fair dealing and replevin relating to a license agreement that we entered into with the vendor in 2005 to license the vendor's software. In addition, the vendor sought a temporary restraining order and preliminary injunction prohibiting us from using the software during the course of the litigation. The temporary restraining order was denied, however we have since stopped using such vendor's software and have begun using software provided by a different vendor. On February 4, 2008, we filed a motion for partial summary judgment, to which the other side submitted a reply. Although we denied any liability, we argued that the agreement between us and such vendor clearly limits the amount of our total liability to the aggregate amounts we had paid such vendor (\$111,350). Rather than incur the costs and expenses (including attorneys' fees) that would be required to defend the action – which we believe would certainly be greater than \$111,350 – we petitioned the court to require the vendor to accept such amount from us as a full and final settlement of all amounts owing between the parties and, upon our tendering such amount, to dismiss the case. The court has not yet ruled on this motion. In the event that our motion is not granted, we plan to continue to defend the action and do not anticipate that this will be a material event in the event liability is found.

We, as well as certain of our former officers and directors, were named as co-defendants in a number of purported securities class actions in United States District Court for the Southern District of New York, arising out of our initial public offering (our "IPO") in November 1999. In addition, a number of other issuers and underwriters of public offerings of such issuers (including the underwriters of our IPO) were named as defendants in such class action suits in connection with such public offerings. A proposed omnibus settlement between the plaintiffs and certain issuer defendants (including us) was suspended when the district court signed a stipulation terminating the settlement approval process. The case is currently being litigated against a small number of focus issuers (which does not include the Company) selected by the district court. If the settlement does not occur, and litigation against us recommences, we believe that we have meritorious defenses to the claims us and we intend to defend the case vigorously.

The Company is not a party to any other material litigation and is not aware of any other pending or threatened litigation that could have a material adverse effect on it or its business taken as a whole.

c. Other marketing and cooperation agreements

The Company has entered into marketing and cooperation agreements with various other companies that maintain sites on the Web. Pursuant to certain of these agreements, the Company is obligated to pay commissions based on revenues derived from such Web links.

d. Stand-by letters of credit

At March 27, 2008, the company had stand-by letters of credit totaling \$1.5 million, which were issued to guarantee certain contractual obligations, and are secured by certificates of deposit and money market funds at the Company's banks. These amounts are recorded in the restricted cash and investments line items on the consolidated balance sheets.

e. Regulation

To date, the FCC has not imposed traditional common carrier regulation upon providers of Internet communications services, but it has begun regulating this area on a limited basis as outlined in this section. On February 12, 2004, the FCC initiated a generic rulemaking proceeding concerning the provision of voice and other services using IP technology, including assessing whether VoIP services should be classified as information services or telecommunications services. In November 2004, the FCC determined that VoIP services with certain characteristics are interstate services subject to federal rather than state jurisdiction. The FCC's determination has been appealed to a federal court of appeals. The Company believes that some of the VoIP services that it provides constitute information services while others are classified as "interconnected VoIP services," which are discussed more below. The FCC's generic rulemaking proceeding, however, could result in the FCC determining, for instance, that certain types of Internet telephony should be regulated like basic telecommunications services. Thus, Internet telephony could no longer be exempt from access charges, which reimburse local carriers for use of their local telephone network, telecommunications related regulatory obligations, or other economic regulations typically imposed on traditional telecommunications carriers.

The imposition of access charges and other types of regulatory fees and charges or the costs of complying with certain regulations could substantially increase the Company's costs of serving its customers in the U.S. The Company may have to increase its prices to cover these costs, which could have a negative impact on the Company's ability to compete with other telephony providers. The Company cannot predict what additional regulations, or the extent of such regulation, if any, the FCC may impose. The Company also cannot predict when the FCC will issue a final decision, the outcome of the decision, or the result of any subsequent proceedings or actions that may arise out of the FCC's decision. As a result, the Company cannot assure you that some or all of its products and services will not be more heavily regulated in the future.

On June 3, 2005, the FCC released an order and notice of proposed rulemaking concerning VoIP emergency 911 services. The order set forth two primary requirements for providers of "interconnected VoIP services", meaning VoIP services that can be used to send and receive calls to or from users on the public switched telephone network. The order applies to the Company's iConnectHere customers. The Company does not believe that it is responsible for compliance with this order in connection with the services sold to its customers who purchase its services for the provision of services directly to end users. Clarification of this issue has been raised by similar providers with the FCC, however, the FCC has not addressed it to date and the Company cannot predict how the FCC would rule on this issue. Furthermore, depending on the FCC's ruling on this issue, the Company cannot predict whether it would be subject to any third-party litigation in connection with such customers who resell the Company's services.

First, the order required the Company to notify its iConnectHere customers of the differences between the emergency services available through the Company and those available through traditional telephony providers. The Company also had to receive affirmative acknowledgment from all of the iConnectHere customers that they understand the nature of the emergency services available through the service. On September 27, 2005, the FCC's Enforcement Bureau released an order stating that the Enforcement Bureau will not pursue enforcement actions against VoIP providers, like the Company, that have received affirmative acknowledgment from at least 90% of their subscribers. The Company is required to file a report with the FCC when it receives affirmative acknowledgments from 100% of its customer base. The Company has received affirmative acknowledgment from more than 95% of the iConnectHere customers that they understand the nature of the

emergency services available through the Company's service, and thus the Company believes it is substantially in compliance with the first aspect of the FCC's June 3 order.

Second, the order required the Company to provide enhanced emergency dialing capabilities, or E-911, to all of the iConnectHere customers by November 28, 2005. Under the terms of the order, the Company is required to use the dedicated wireline E-911 network to transmit customers' 911 calls, callback number and customer-provided location information to the emergency authority serving the customer's specified location.

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On November 7, 2005, the FCC's Enforcement Bureau issued a Public Notice with respect to that requirement. The Public Notice indicated that providers who have not fully complied with the enhanced emergency dialing capabilities requirement are not required to discontinue the provision of services to existing clients, but that the FCC expects that such providers will discontinue marketing their services and accepting new customers in areas in which the providers cannot offer enhanced emergency dialing capabilities.

The Company also has taken many significant steps to comply with the enhanced emergency service rules, but it was unable to comply with all of the requirements of the FCC's order by the November 28, 2005 deadline. Some of the Company's iConnectHere customers currently receive E-911 service in conformity with the FCC's order, but a number of iConnectHere customers do not receive such service. These are customers who were receiving service prior to the FCC's deadline for compliance with the E-911 regulations. The FCC permitted service providers to continue to provide service to those existing customers rather than disconnect those customers. Pursuant to the FCC's requirement, after the implementation of the FCC E-911 requirements, the Company provides services to customers only where it can provide the FCC required E-911 service. The Company may be required to stop serving those iConnectHere customers to whom it cannot provide the required enhanced emergency dialing capabilities that were being serviced prior to the issuance of the FCC's rules at any time, but this is difficult to predict at this time.

In orders issued in September 2005 and May 2006, the FCC also has determined that interconnected VoIP providers must comply with the Communications Assistance for Law Enforcement Act, or CALEA, which requires providers to assist law enforcement agencies in conducting lawfully authorized electronic surveillance. The FCC established a deadline of May 14, 2007 for VoIP providers to comply with the requirements of CALEA. As a result of the steps we have taken, we believe that we comply with the CALEA.

The FCC decided in June 2006 that interconnected VoIP service providers should be required to contribute to the universal service fund on an interim basis. The amount of universal service contribution for interconnected VoIP service providers is based on a percentage of revenues earned from end user interstate services. Additional changes to the assessment and recovery rules for universal service may affect our financial results.

On April 2, 2007, the FCC issued an order that tightened existing rules on protection and use of Customer Proprietary Network Information, or CPNI, and extended coverage of the CPNI rules to interconnected VoIP service providers (such as the Company). Although the rules are aimed in large part at preventing the practice of pretexting (in which a caller impersonates a phone customer to gain access to his or her phone records), the rules impose greater obligations on us and other companies like us to protect customer calling and network information and to file formal certifications with the FCC regarding procedures for protecting this information. Failure to comply is subject to FCC enforcement. The new rules went into effect on December 8, 2007. We do not expect these rules, or our ability to comply with them, to have a material adverse effect on our operations, financial position or results of operations.

Note 10 - Stockholders' equity

a. Share capital

Following the Company's initial public offering, effective December 1999, the Company's stock was listed on The Nasdaq National Market System. On September 17, 2002 the listing of the Company's common stock was transferred from The Nasdaq National Market to The Nasdaq Capital Market. On March 28, 2008, the Company's common stock was delisted from The Nasdaq Capital Market and began to be listed and traded on the OTC Bulletin Board (OTCBB).

b. Stock Options

In November 1999, the Company's Board established the 1999 Stock Incentive Plan. Under this plan, 4,000,000 shares of Class A were reserved for issuance upon exercise of awards to be granted. On September 23, 2004 the Board of Directors adopted the 2004 Stock Incentive Plan and it was subsequently approved by the stockholders at the annual meeting on November 8, 2004. This plan replaced the 1999 Stock Incentive Plan. Under the 2004 Stock Incentive Plan, the Compensation Committee is authorized to grant options for 759,732 shares of common stock (which represents 4,000,000 shares of common stock reserved under the 1999 Stock Incentive Plan less the amount of shares represented by awards previously granted under the 1999 Stock Incentive Plan and exercised or outstanding as of September 28, 2004), plus (b) such additional shares of common stock as are represented by awards previously granted under the 1999 Stock Incentive Plan which are cancelled or without delivery of shares of stock by the Company. In addition, the Company's compensation committee may grant both incentive and non-incentive stock options for shares of Class A Common Stock of the Company. The options generally have a term of seven years and become exercisable in three equal installments commencing on the first anniversary of the date of the grant. The purchase price per share payable upon exercise of an option is no less than the fair market value of the share at the date of grant.

In November 1999, the Company adopted the 1999 Directors' Compensation Plan. Under this plan, 600,000 shares of Class A were reserved for issuance upon exercise of awards to be granted to non-employee directors. On September 23, 2004 the Board of Directors adopted the 2004 Non-employee Director Stock Option Plan and it was subsequently approved by the stockholders at the annual meeting on November 8, 2004. This plan replaced the 1999 Director' Plan. Under the 2004

Non-employee Director Stock Option Plan, the Compensation Committee is authorized to grant options for 351,216 shares of common stock (which represents 600,000 shares of common stock reserved under the 1999 Directors' Compensation Plan less the amount of shares represented by awards previously granted under the 1999 Directors' Compensation Plan and exercised or outstanding as of September 28, 2004), plus (b) such additional shares of common stock as are represented by awards previously granted under the 1999 Directors' Compensation Plan which are cancelled or without delivery of shares of stock by the Company. The options generally have a term of seven years and become exercisable commencing on the first anniversary of the date of the grant. The purchase price per share payable upon exercise of an option is no less than the fair market value of the share at the date of grant.

At the Company's 2005 Annual Shareholders Meeting, the shareholders approved an amendment to the Company's 2004 Stock Incentive Plan to increase the number of options to purchase shares of our common stock under that plan by 2,000,000, and also approved an amendment to the Company's 2004 Non-Employee Director Stock Option Plan to increase the number of options to purchase shares of our common stock under that plan by 500,000.

As of December 31, 2007, options to purchase 1,560,020 shares of Class A Common Stock were exercisable and outstanding with exercise prices ranging between \$1.02 and \$10.25 per share.

A summary of the status of the Company's stock option plans as of December 31, 2007, 2006 and 2005 and changes during the years then ended, is presented below:

	December 31, 2007		December 31, 2006		December 31, 2005	
	Number of Options	Weighted average Exercise price	Number of Options	Weighted average Exercise price	Number of Options	Weighted average Exercise price
Options outstanding at beginning of year	2,330,835	\$ 2.06	2,762,686	\$ 2.58	3,066,939	\$ 2.50
Granted during the year	-	-	105,000	3.17	120,000	3.06
Exercised during the year	35,000	0.89	68,982	1.04	352,253	1.10
Forfeited during the year	735,815	1.02	467,869	5.53	72,000	6.72
Outstanding at end of year	<u>1,560,020</u>	1.91	<u>2,330,835</u>	2.06	<u>2,762,686</u>	\$ 2.58
Weighted average fair value of options granted during the year	<u>\$ 0.00-</u>		<u>\$ 3.17</u>		<u>\$ 3.06</u>	

Additional information regarding options outstanding as of December 31, 2007 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Outstanding	Weighted average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of Exercisable Options	Weighted Average Exercise Price
\$ 0.74 – \$1.02	363,266	1.1	1.01	363,266	1.01
\$ 1.13 – \$1.38	510,458	1.2	1.23	510,458	1.23
\$ 1.75 – \$2.15	161,348	2.9	1.81	161,348	1.81
\$ 2.85 – \$3.20	514,348	5.7	2.95	481,015	2.95
\$ 10.25 – \$15.00	10,600	1.3	10.25	10,600	10.25
	<u>1,560,020</u>	<u>3.8</u>	<u>\$ 1.91</u>	<u>1,526,687</u>	<u>\$ 1.88</u>

c. Restricted shares of the Company's Common Stock

During the year ended December 31, 2007, the Company granted restricted shares of the Company's common stock to retain, reward, and motivate those employees who are deemed critical to the future success of the Company. The restricted shares of common stock were granted pursuant to the Company's 2004 Stock Incentive Plan, which was approved by the Board of Directors and stockholders of the Company. The restricted shares are subject to certain forfeiture provisions, and therefore are restricted as to transferability until such forfeiture restrictions have lapsed. The restrictions relate to continued service with the Company. The vesting period for such restricted shares of common stock is typically three years. The intrinsic value of the restricted shares of common stock issued to employees of the Company is amortized as of the date of grant to compensation expense over the vesting period of such grant.

During 2007, the Company recognized approximately \$154,775 of compensation expense related to the amortization of the restricted shares of common stock. During 2007, the Company granted a total of 15,000 restricted shares of common stock to its employees.

d. Non-employee restricted stock plan

On July 5, 2006, the Board approved the 2006 Non-Employee Director Stock Plan ("2006 Stock Plan") and it was subsequently approved by the stockholders at the annual meeting on September 8, 2006. The 2006 Stock Plan provides for the automatic grant of restricted stock. With the adoption of this plan, the 2004 Non-employee Stock Option Plan was terminated except with respect to outstanding options previously granted thereunder. The 2006 Stock Plan permits only the grant of restricted shares to purchase shares of our common stock. The aggregate number of shares of restricted stock that may be issued under the 2006 Stock Plan shall be 500,000 shares, which represents the number of additional shares underlying potential option grants that were available under the 2004 Non-Employee Option Plan approved for issuance by our stockholders at our 2004 annual stockholders' meeting. A grant of restricted stock under the 2006 Stock Plan is a grant of shares of the common stock that, at the time of issuance, are subject to certain forfeiture provisions, and thus are restricted as to transferability until such forfeiture restrictions have lapsed. The restrictions on the restricted stock issued pursuant to the Plan relate to continued service on the Company's board of directors (lapsing on a monthly basis). If the Company reacquires (at not more than its original issuance price) any shares of restricted stock or if any shares of restricted stock are forfeited, or otherwise cancelled or terminated, such shares which were subject to such restricted stock award shall again be available for issuance from time to time pursuant to the 2006 Stock Plan. At December 31, 2007, no shares of restricted stock were awarded to non-employee directors under the plan.

Note 11 - Research and development expenses

Research and development expenses consist of the following:

	Year ended December 31,		
	(\$ in thousands)		
	2007	2006	2005
Salaries and related expenses	\$ 3,498	\$ 2,370	\$ 2,331
Consulting and advisory fees	235	297	101
Travel	104	816	104
Other	832	560	692
Total research and development expenses	<u>\$ 4,669</u>	<u>\$ 4,043</u>	<u>\$ 3,228</u>

Note 12 - Income taxes**a. Provision for income taxes**

No provision for income taxes was required for the years ended December 31, 2007, 2006 and 2005 due to net losses in these periods.

b. Tax loss carryforwards

As of December 31, 2007, the Company had net operating loss carryforwards generated in the U.S. and Israel of approximately \$67,910,000 -and \$6,376,000, respectively. The Company's U.S. net operating loss carryforwards will expire at various dates between 2012 and 2025 if not utilized. In addition, a portion of those net operating loss carryforwards could be subject to limitation due to changes in ownership of the Company. The Company's net operating losses generated in Israel may be carried forward indefinitely. The Israeli subsidiary received final tax assessments through the tax year ended December 31, 1999.

c. In accordance with SFAS No. 109, the components of deferred income taxes are as follows:

	December 31,	
	2007	2006
	(\$ in thousands)	
Net operating losses carryforwards\$	26,042	\$ 20,822
Less valuation allowance	(26,042)	(20,822)
Net deferred tax assets	\$ —	\$ —

As of December 31, 2007, and 2006, a valuation allowance of \$26,042,000 and \$20,822,000, respectively, is provided as the realization of the deferred tax assets are not assured.

	Year ended December 31,		
	2007	2006	2005
	(US\$ in thousands)		
Domestic	\$ (9,497)	\$ 250	\$ (782)
Foreign	309	257	(28)
Total	\$ (9188)	\$ 507	\$ (810)

Note 13 -Segment reporting, geographical information and major customers

The Company operates in one business segment, IP Telephony services, and makes business decisions and allocates resources accordingly.

The following table summarizes the Company's revenues and long-lived assets by country. Revenue is attributed to geographic region based on the location of the customers. Long-lived assets are attributed to geographic region based on the country in which the assets are located.

	Year ended December 31,		
	2007	2006	2005
	(\$ in thousands)		
Revenues:			
United States	\$ 12,677	\$ 16,855	\$ 9,573
Europe	5,682	2,758	1,378
South America	3,949	6,703	3,603
Far East	2,559	5,092	5,009
Middle East	3,744	5,238	8,551
Other	866	1,307	1,600
Total revenues	\$ 29,477	\$ 37,953	\$ 29,714

Revenues from major customers
exceeding 10% of revenues:

Master Reseller – A	--%	--%	--%
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	December 31,	
	2007	2006
	(\$ in thousands)	
Long-lived assets:		
United States	2,363	3,068
Israel	385	297
Europe	68	93
Other	66	-
Total long-lived assets	2,882	3,458

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Selected Quarterly Financial Information (Unaudited)

	Three Months Ended,			
	March 31	June 30	September 30	December 31
	(\$ in thousands, except per share data)			
2007				
Total revenues	\$ 8,312	\$ 7,602	\$ 7,260	\$ 6,303
Costs and operating expenses:				
Cost of revenues	5,276	5,551	5,284	4,996
Research and development expenses	1,136	1,107	1,154	1,273
Selling and marketing expenses	1,227	1,318	1,267	1,256
General and administrative expenses	612	649	902	789
Write down of intangible asset	-	-	-	2,680
Depreciation and amortization	568	774	783	519
Total costs and operating expenses	<u>8,819</u>	<u>9,399</u>	<u>9,390</u>	<u>11,513</u>
Loss from operations	(507)	(1,797)	(2,130)	(5,210)
Other non operating income	-	-	-	13
Interest income, net	120	175	97	50
Profit (Loss) before income taxes	(387)	(1,622)	(2,033)	(5,147)
Income taxes	10	17	91	8
Net Profit (loss)	<u>\$ (397)</u>	<u>\$ (1,639)</u>	<u>\$ (2,124)</u>	<u>\$ (5,155)</u>
Net loss per share - basic and diluted	<u>\$ (0.01)</u>	<u>\$ (0.05)</u>	<u>\$ (0.06)</u>	<u>\$ (0.16)</u>
Basic weighted average number of shares outstanding	<u>31,288,130</u>	<u>32,781,545</u>	<u>32,795,045</u>	<u>32,843,752</u>
Diluted weighted average number of shares outstanding	<u>31,288,130</u>	<u>32,781,545</u>	<u>32,795,045</u>	<u>32,843,752</u>
2006				
Total revenues	\$ 10,749	\$ 9,966	\$ 8,537	\$ 8,701
Costs and operating expenses:				
Cost of revenues	7,194	6,166	5,331	5,684
Research and development expenses	1,080	1,044	961	958
Selling and marketing expenses	1,202	1,271	1,276	1,207
General and administrative expenses	932	732	693	731
Depreciation and amortization	371	379	389	404
Total costs and operating expenses	<u>10,779</u>	<u>9,592</u>	<u>8,650</u>	<u>8,984</u>
Loss from operations	(30)	374	(113)	(283)
Interest income, net	129	148	162	181
Profit (Loss) before income taxes	99	522	49	(102)
Income taxes	11	26	19	5
Net loss	<u>\$ 88</u>	<u>\$ 496</u>	<u>\$ 30</u>	<u>\$ (107)</u>
Net loss per share - basic and diluted	<u>\$ (0.00)</u>	<u>\$ 0.02</u>	<u>\$ 0.00</u>	<u>\$ (0.00)</u>
Basic weighted average number of shares outstanding	<u>29,741,307</u>	<u>29,745,897</u>	<u>29,788,403</u>	<u>29,807,755</u>
Diluted weighted average number of shares outstanding	<u>30,673,141</u>	<u>30,604,982</u>	<u>29,907,650</u>	<u>29,807,755</u>

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in New York, New York on March 31, 2008.

DELTATHREE, INC.

By: /s/Shimmy Zimels
Shimmy Zimels
Chief Executive Officer and President
(Principal Executive Officer, Principal Financial Officer
and Principal Accounting Officer)

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Shimmy Zimels his true and lawful attorney-in-fact, acting alone, with full power of substitution, for and in the name, place and stead of the undersigned, in any and all capacities to sign any and all amendments to this Annual Report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, and hereby grants to such attorney-in-fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as the undersigned might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent or his substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report has been signed by the following persons in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/Shimmy Zimels	Chief Executive Officer, President and Director (Principal Executive Officer, Principal Financial Officer and Principal Accounting Officer)	March 31, 2008
/s/Noam Bardin	Director	March 31, 2008
/s/Ilan Biran	Director	March 31, 2008
/s/Benjamin Broder	Director	March 31, 2008
/s/Lior Samuelson	Chairman of the Board of Directors	March 31, 2008

EXHIBIT INDEX

The following documents are filed as exhibits to this report on Form 10-K or incorporated by reference to exhibits previously filed with the Securities and Exchange Commission.

Exhibit Number	Description
2.1	Asset Transfer Agreement dated February 17, 2007 by and between deltathree, Inc. and Go2Call.com, Inc. (Incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K, filed on February 20, 2007).
3.1.1	Form of Restated Certificate of Incorporation of deltathree, Inc. (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
3.1.2	Form of Amendment to Restated Certificate of Incorporation of deltathree, Inc. (Incorporated by reference to our Annual Report on Form 10-K/A, filed on April 30, 2001).
3.2	Form of Amended and Restated By-laws of deltathree, Inc. (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
4.1	Specimen Certificate of Class A Common Stock (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
4.2	Specimen Certificate of Class B Common Stock (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
10.1	Form of deltathree, Inc. 1999 Stock Incentive Plan (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).+
10.2	Form of deltathree, Inc. 1999 Employee Stock Purchase Plan (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).
10.3	Form of deltathree, Inc. 1999 Performance Incentive Plan (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).+
10.4	Form of deltathree, Inc. 1999 Directors' Plan (Incorporated by reference from our registration statement on Form S-1 (Registration No. 333-122242)).+
10.5	Employment Agreement, effective as of April 26, 2004, between Shimmy Zimels and deltathree, Inc. (Incorporated by reference to our annual report on Form 10-K/A, filed on April 29, 2004).+
10.6	2004 Stock Incentive Plan (Incorporated by reference to our registration statement on Form S-8 (Registration No. 333-86503)).+
10.7	2004 Non-Employee Director Stock Option Plan (Incorporated by reference to our registration statement on Form S-8 (Registration No. 333-86503)).+
10.8	Form of Option Agreement Pursuant to 2004 Stock Incentive Plan (Incorporated by reference to our Annual Report on Form 10-K, filed on March 31, 2005).+
10.9	Form of Option Agreement Pursuant to 2004 Non-Employee Director Stock Option Plan (Incorporated by reference to our Annual Report on Form 10-K, filed on March 31, 2005).+
10.10	Executive and Director Compensation Arrangements (Incorporated by reference to our Annual Report on Form 10-K, filed on March 31, 2005).+
10.11	First Amendment to the deltathree, Inc. 2004 Stock Incentive Plan, dated as of December 20, 2005 (Incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K, filed on December 21, 2005).+
10.12	First Amendment to the deltathree, Inc. 2004 Non-Employee Director Stock Option Plan, dated as of December 20, 2005 (Incorporated by reference to Exhibit 10.2 of our Current Report on Form 8-K, filed on December 21, 2005).+
10.13	Registration Rights Agreement dated February 19, 2007 by and between deltathree, Inc. and Go2Call.com, Inc. (Incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K, filed on February 20, 2007).
10.14	

deltathree, Inc. Amended and Restated 1999 Performance Incentive Plan (Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K, filed on July 11, 2006).+

- 10.15 Deltathree, Inc. 2006 Non-Employee Director Stock Plan (Incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K, filed on September 8, 2006).+
- 10.16* Form of Restricted Unit Agreement Pursuant to 2004 Stock Incentive Plan.+
- 10.17 Employment Agreement, dated as of February 1, 2008, between Lior Samuelson and deltathree, Inc. (Incorporated by reference to our Current Report on Form 8-K, filed on February 4, 2008).+
- 14.1 deltathree, Inc. Corporate Code of Conduct and Ethics (Incorporated by reference to our annual report on Form 10-K, filed on March 30, 2004).
- 21.1* Subsidiaries of deltathree, Inc.
- 23.1* Consent of Brightman Almagor & Co.
- 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* Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

+ Management contract or compensatory plan.

**RESTRICTED UNIT AGREEMENT
DELTATHREE, INC.**

This Restricted Unit Agreement (this "Agreement") is made as of the [____] day of [____], [____] (the "Grant Date"), between deltathree, Inc., a Delaware corporation (the "Company"), and [_____] (the "Participant").

WHEREAS, the Company has adopted the 2004 Stock Incentive Plan, as amended (the "Plan"), to promote the interests of the Company by providing an incentive for employees and consultants of the Company and its Affiliates (any terms used and not defined herein shall have the meanings ascribed to such terms in the Plan);

WHEREAS, pursuant to the provisions of the Plan, the Company desires to offer to the Participant units ("Units") that are convertible, at the option of Participant, into an equal number of shares ("Shares") of the Company's Class A common stock, par value \$0.001 per share ("Common Stock"), in accordance with the provisions of the Plan, all on the terms and conditions hereinafter set forth; and WHEREAS, Participant wishes to accept said offer;

NOW, THEREFORE, in consideration of the premises and the mutual covenants contained herein and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto, intending to be legally bound, hereby agree as follows:

1. Terms of Grant. The Participant hereby accepts the offer of the Company to issue to the Participant, in accordance with the terms of the Plan and this Agreement, [_____] (_____) Units (such Units, subject to adjustment pursuant to Subsection 2.1(g) hereof, the "Restricted Units"), receipt of which is hereby acknowledged by the Participant's service to the Company and which will be reported by the Participant in accordance with all tax laws applicable to Participant.

2.1. Restricted Period and Forfeiture Provisions.

(a) Forfeiture. In the event that the Participant is no longer an employee or consultant of the Company or an Affiliate for any reason, other than for a reason as specified in Section 2.1(b) or 2.1(c) below, prior to the third anniversary of the Grant Date (the "Termination"), a number of Restricted Units shall become vested and shall not be forfeited in accordance with the vesting schedule set forth on Schedule A attached hereto. Upon the expiration or termination of the Restricted Period, the restrictions applicable to the Restricted Units shall lapse pursuant to Sections 7(c) and (d) of the Plan.

(b) Effect of Termination for Disability, Death, Early Retirement, or Normal Retirement. In the event the Participant's Employment terminates due to the Participant's (i) death, (ii) disability, (iii) Early Retirement with the consent of the Committee or (iv) Normal Retirement, a certain number of Restricted Units shall vest and not be forfeited in accordance with Section 7(b) of the Plan.

(c) Effect of a For Cause Termination. Notwithstanding anything to the contrary contained in this Agreement, in the event the Company or an Affiliate terminates the Participant's employment or service for "cause" (as defined in the Plan) or in the event the Administrator determines, within one (1) year after the Participant's termination, that either prior or subsequent to the Participant's termination the Participant engaged in conduct that would constitute "cause," all of the Restricted Units then held by the Participant shall be forfeited to the Company immediately as of the time the Participant is notified that he or she has been terminated for "cause" or that he or she engaged in conduct which would constitute "cause".

(d) Change of Control. The Committee shall determine the effect that certain events (including a change of control) will have on the vesting and forfeiture of the Restricted Units.

(e) Prohibition on Transfer. The Participant recognizes and agrees that during the Restricted Period the Restricted Units (except as provided in this Section 2.1) may not be sold, transferred, assigned, hypothecated, pledged, encumbered or otherwise disposed of, whether voluntarily or by operation of law, other than to the Company (or its designee). However, the Participant, with the approval of the Administrator, may transfer the Restricted Units for no consideration to or for the benefit of the Participant's Immediate Family (including, without limitation, to a trust for the benefit of the Participant's Immediate Family or to a partnership or limited liability company for one or more members of the Participant's Immediate Family), subject to such limits as the Administrator may establish, and the transferee shall remain subject to all the terms and conditions applicable to this Agreement prior to such transfer and each such transferee shall so acknowledge in writing as a condition precedent to the effectiveness of such transfer. The term "Immediate Family" shall mean the Participant's spouse, former spouse, parents, children, stepchildren, adoptive relationships, sisters, brothers, nieces and nephews and grandchildren (and, for this purpose, shall also include the Participant). The Company shall not be required to transfer any Restricted Units on its books which shall have been sold, assigned or otherwise transferred in violation of this Subsection 2.1(e), or to treat as the owner of such Restricted Units, or to pay dividends to, any person or organization to which any such Restricted Units shall have been so sold, assigned or otherwise transferred, in violation of this Subsection 2.1(e).

(f) Failure to Deliver Restricted Stock to be Forfeited. In the event that the Restricted Units to be forfeited to the Company under this Agreement are not in the Company's possession and the Participant or the Participant's Survivor fails to deliver such Restricted Units to the Company (or its designee), the Company may immediately take such action as is appropriate to transfer record title of such Restricted Units from the Participant to the Company (or its designee) and treat the Participant and such Restricted Units

in all respects as if delivery of such Restricted Units had been made as required by this Agreement. The Participant hereby irrevocably grants the Company a power of attorney which shall be coupled with an interest for the purpose of effectuating the preceding sentence.

(g) Adjustments. The Plan contains provisions covering the treatment of Units and Shares in a number of contingencies such as stock splits and mergers. Provisions in the Plan for adjustment with respect to the Restricted Units and any Shares acquired upon conversion of Units and the related provisions with respect to successors to the business of the Company are hereby made applicable hereunder and are incorporated herein by reference.

2.2 General Restrictions on Transfer of Restricted Units.

(a) The Participant agrees that in the event the Company proposes to offer for sale to the public any of its equity securities and such Participant is requested by the Company and any underwriter engaged by the Company in connection with such offering to sign an agreement restricting the sale or other transfer of Units or Shares, then it will promptly sign such agreement and will not transfer, whether in privately negotiated transactions or to the public in open market transactions or otherwise, any Units or Shares or other securities of the Company held by him or her during such period as is determined by the Company and the underwriters, not to exceed 90 days following the closing of the offering, plus such additional period of time as may be required to comply with Marketplace Rule 2711 of the National Association of Securities Dealers, Inc. or similar rules thereto (such period, the "Lock-Up Period"). Such agreement shall be in writing and in form and substance reasonably satisfactory to the Company and such underwriter and pursuant to customary and prevailing terms and conditions. Notwithstanding whether the Participant has signed such an agreement, the Company may impose stop-transfer instructions with respect to the Units or Shares or other securities of the Company subject to the foregoing restrictions until the end of the Lock-Up Period.

(b) The Participant acknowledges and agrees that neither the Company nor its shareholders, directors and officers, has any duty or obligation to disclose to the Participant any material information regarding the business of the Company or affecting the value of the Units or Shares before, at the time of, or following a Termination, including, without limitation, any information concerning plans for the Company to make a public offering of its securities or to be acquired by or merged with or into another firm or entity.

3. Conversion of Units into Shares of Common Stock. Following such time as any Restricted Units become vested, except as provided herein the Participant may convert some or all of such Units into an equal number Shares of Common Stock at a purchase price of \$0.001 per Share (which such amount may be withheld by the Company from future payments to be made by the Company to the Participant), by providing written notice thereof to the Senior Vice President of Finance and Treasurer of the Company as provided in Section 10 below. Such notice shall include, at a minimum, the Participant's name and the number of Units that the Participant elects to so convert. Within three (3) business days of its receipt of such request, the Company shall arrange to have such number of Shares transferred into a separate account for the Participant at the brokerage house that holds the Company's securities.

4. Securities Law Compliance. The Participant specifically acknowledges and agrees that any sales of Restricted Units shall be made by the Participant solely in accordance with the requirements of the U.S. Securities Act of 1933, as amended.

5. Rights as a Stockholder. The Participant shall have all the rights set forth in Section 7(e) of the Plan.

6. Incorporation of the Plan. The Participant specifically understands and agrees that the Restricted Units issued under the Plan are being provided to the Participant pursuant to the Plan, a copy of which the Participant acknowledges he or she has read and understands and by which he or she agrees to be bound. The provisions of the Plan are incorporated herein by reference. Copies of the Plan and the Summary Plan Description of the Plan are accessible at:

[Link to webpage]

7. Tax Liability of the Participant and Payment of Taxes. The Participant acknowledges and agrees that any income or other taxes due from the Participant with respect to the Restricted Units or the Stock issued pursuant to this Agreement shall be the Participant's sole responsibility. Without limiting the foregoing, the Participant agrees that, to the extent that the conversion of Units into Shares of Common Stock or the declaration of dividends on any Restricted Units before the lapse of restrictions on disposition of any such Units results in the Participant's being deemed to be in receipt of earned income under the provisions of the Code, the Company shall be entitled to immediate payment from the Participant of the amount of any tax required to be withheld by the Company. Without limiting the foregoing, in the event that the Participant shall no longer be an employee or consultant of the Company or any Affiliate and such Participant is entitled to Restricted Units pursuant to the terms of this Agreement, the Participant agrees to take any action to settle any outstanding tax matters (including required payments, if applicable) with the Company arising from the conversion of Units into Shares of Common Stock within ten (10) days of the date that the Participant ceases to be an employee or consultant of the Company or any Affiliate.

The Participant acknowledges that at such times as the Restricted Units are converted into Shares of Common Stock in accordance with Section 3 above the Participant will have income for tax purposes equal to the fair market value of the Shares at such date less the price paid for the Restricted Units by the Participant. If the Participant is a United States taxpayer, the Participant may be able to file an election under Section 83 of the Code and elect to include the gross income in the year of the transfer of the Stock. If the Participant makes such election, the Participant shall provide the Company with a copy of such form of election. The Participant understands and acknowledges that he or she should obtain the advice of his or her tax advisors with respect to the tax consequences of the Restricted Units, the conversion of such Units into Shares, and the provisions of this Agreement.

8. Equitable Relief. The Participant specifically acknowledges and agrees that in the event of a breach or threatened breach of the provisions of this Agreement or the Plan, including the attempted transfer of the Restricted Units by the Participant in violation of this Agreement, monetary damages may not be adequate to compensate the Company, and, therefore, in the event of such a breach or threatened breach, in addition to any right to damages, the Company shall be entitled to equitable relief in any court having competent jurisdiction. Nothing herein shall be construed as prohibiting the Company from pursuing any other remedies available to it for any such breach or threatened breach.

9. No Obligation to Maintain Relationship. The Company is not obligated, by the Plan or this Agreement, to continue to employ or engage the Participant as an employee or consultant of the Company or an Affiliate. The Participant acknowledges: (i) that the Plan is discretionary in nature and may be suspended or terminated by the Company at any time; (ii) that the grant of the Restricted Units is a one-time benefit which does not create any contractual or other right to receive future grants of Units or benefits in lieu of Units; (iii) that all determinations with respect to any such future grants, including, but not limited to, the times when Units shall be granted, the number of Units to be granted, the purchase price per Share acquirable upon conversion of Units, and the time or times when each Unit shall be free from a lapsing repurchase or forfeiture right, will be at the sole discretion of the Company; (iv) that the Participant's participation in the Plan is voluntary; (v) that the value of the Units is an extraordinary item of compensation which is outside the scope of the Participant's employment contract, if any; and (vi) that the Units are not part of normal or expected compensation for purposes of calculating any severance, resignation, redundancy, end of service payments, bonuses, long-service awards, pension or retirement benefits or similar payments.

10. Notices. Any notices required or permitted by the terms of this Agreement or the Plan shall be given in person or by recognized overnight courier service, facsimile or e-mail (in either case with confirmation of receipt), registered or certified mail (return receipt requested), addressed as follows:

If to the Company:

deltathree, Inc.
75 Broad Street, 31st Floor
New York, NY 10004
Attn: Senior Vice President of Finance and Treasurer

If to the Participant:

or to such other address or addresses of which notice in the same manner has previously been given. Any such notice shall be deemed to have been given on the earliest of receipt, one business day following delivery by the sender to a recognized overnight courier service, upon delivery by facsimile or e-mail during normal business hours with confirmation of receipt, or three business days following mailing by registered or certified mail.

11. Benefit of Agreement. Subject to the provisions of the Plan and the other provisions hereof, this Agreement shall be for the benefit of and shall be binding upon the heirs, executors, administrators, successors and assigns of the parties hereto.

12. Governing Law. This Agreement shall be construed and enforced in accordance with the laws of the State of Delaware, without giving effect to the conflict of law principles thereof. For the purpose of litigating any dispute that arises under this Agreement, whether at law or in equity, the parties hereby consent to exclusive jurisdiction in New York and agree that such litigation shall be conducted in the state courts of New York or the federal courts of the United States District Court for the Southern District of New York.

13. Severability. If any provision of this Agreement is held to be invalid or unenforceable by a court of competent jurisdiction, then such provision or provisions shall be modified to the extent necessary to make such provision valid and enforceable, and to the extent that this is impossible, then such provision shall be deemed to be excised from this Agreement, and the validity, legality and enforceability of the rest of this Agreement shall not be affected thereby.

14. Entire Agreement. This Agreement, together with the Plan, constitutes the entire agreement and understanding between the parties hereto with respect to the subject matter hereof and supersedes all prior oral or written agreements and understandings relating to the subject matter hereof. No statement, representation, warranty, covenant or agreement not expressly set forth in this Agreement shall affect or be used to interpret, change or restrict the express terms and provisions of this Agreement provided, however, in any event, this Agreement shall be subject to and governed by the Plan.

15. Modifications and Amendments; Waivers and Consents. The terms and provisions of this Agreement may be modified or amended as provided in the Plan. Except as provided in the Plan, the terms and provisions of this Agreement may be waived, or consent for the departure therefrom granted, only by written document executed by the party entitled to the benefits of such terms or provisions. No such waiver or consent shall be deemed to be or shall constitute a waiver or consent with respect to any other terms or provisions of this Agreement, whether or not similar. Each such waiver or consent shall be effective only in the specific instance and for the purpose for which it was given, and shall not constitute a continuing waiver or consent.

16. Counterparts. This Agreement may be executed in one or more counterparts, and by the different parties hereto on separate counterparts, each of which shall be deemed an original, but both of which together shall constitute one and the same instrument.

17. Data Privacy. By entering into this Agreement, the Participant: (i) authorizes the Company and each Affiliate, and any agent of the Company or any Affiliate administering the Plan or providing Plan record keeping services, to disclose to the Company or any of its Affiliates such information and data as the Company or any such Affiliate shall request in order to facilitate the grant of Units and the administration of the Plan; (ii) waives any data privacy rights he or she may have with respect to such information; and (iii) authorizes the Company and each Affiliate to store and transmit such information in electronic form.

[THE NEXT PAGE IS THE SIGNATURE PAGE]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

DELTATHREE, INC.

By: _____
Name: _____
Title: _____

Participant: _____

Print
Name: _____

SCHEDULE A

Vesting Schedule

[TO BE INSERTED]

Exhibit 21.1

SUBSIDIARIES

Name of Subsidiary	Jurisdiction
Deltathree, Ltd.	Israel

Exhibit 23.1

**CONSENT OF INDEPENDENT
REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Form S-3 (File Nos. 333-109495 and 333-143292) and Form S-8 (File Nos. 333-34156 and 333-122242) of our report, dated March 27, 2008, relating to the financial statements of deltathree, Inc. appearing in this Annual Report on Form 10-K of deltathree, Inc. for the year ended December 31, 2007.

/s/Brightman Almagor & Co.
Certified Public Accountants
A member firm of Deloitte Touche Tohmatsu

Tel Aviv, Israel
March 31, 2008

Exhibit 31.1

CERTIFICATIONS UNDER SECTION 302

I, Shimmy Zimels, certify that:

1. I have reviewed this annual report on Form 10-K of deltathree, Inc.;
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)) 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) [reserved] / [paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986];
 - 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.
6. This annual report does not include an attestation report of the registrant's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the registrant's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the registrant to provide only management's report in this annual report.

Date: March 31, 2008

/s/Shimmy Zimels
Shimmy Zimels, Principal Executive Officer

Exhibit 31.2

CERTIFICATIONS UNDER SECTION 302

I, Shimmy Zimels, certify that:

1. I have reviewed this annual report on Form 10-K of deltathree, Inc.;
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)) 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) [reserved] / [paragraph omitted pursuant to SEC Release Nos. 33-8238 and 34-47986];
 - 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.
6. This annual report does not include an attestation report of the registrant's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the registrant's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the registrant to provide only management's report in this annual report.

Date: March 31, 2008

/s/Shimmy Zimels
Shimmy Zimels, Principal Financial Officer

Exhibit 32

CERTIFICATIONS UNDER SECTION 906

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), each of the undersigned officers of deltathree, Inc., a Delaware corporation (the "Company"), does hereby certify, to such officer's knowledge, that:

The Annual Report for the year ended December 31, 2005 (the "Form 10-K") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 31, 2008

/s/Shimmy Zimels
Shimmy Zimels, Chief Executive Officer
(Principal Executive Officer and Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

