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

FORM 10-Q

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from _____ to _____

Commission File Number: 000-28063

deltathree, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware

(State or other jurisdiction of incorporation or organization)

13-4006766

(I.R.S. Employer Identification Number)

26 Avenue at Port Imperial, Suite #407, West New York, New Jersey

(Address of principal executive offices)

07093

(Zip Code)

(212) 500-4850

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company

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

As of November 5, 2012, the registrant had outstanding 72,273,525 shares of common stock, par value \$0.001 per share.

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**PART I
 FINANCIAL INFORMATION**

Item 1. Financial Statements

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

	As of September 30, 2012	As of December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 288	\$ 214
Restricted cash and short-term investments (reclassified)	272	352
Accounts receivable, net (includes \$160 and \$158 as of September 30, 2012, and December 31, 2011, respectively, from a related party)	620	415
Prepaid expenses and other current assets (reclassified)	232	224
Inventory	47	46
Total current assets	1,459	1,251
Property and equipment, net	282	335
Deposits	77	78
Total assets	\$ 1,818	\$ 1,664
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable (includes \$943 and \$575 as of September 30, 2012, and December 31, 2011, respectively, to a related party)	1,603	1,469
Deferred revenues	676	522
Other current liabilities	857	830
Total current liabilities	3,136	2,821
Long-term liabilities:		
Severance pay obligations	99	112
Long-term loan from a related party (reclassified)	4,183	3,133
Total long-term liabilities	4,282	3,245
Total liabilities	7,418	6,066
Stockholders' deficiency:		
Share capital:		
Common stock, par value \$0.001 per share; authorized: 225,000,000 shares; issued and outstanding: 72,273,525 at September 30, 2012, and December 31, 2011	72	72
Additional paid-in capital	176,991	176,893
Accumulated deficit	(182,663)	(181,367)
Total stockholders' deficiency	(5,600)	(4,402)
Total liabilities and stockholders' deficiency	\$ 1,818	\$ 1,664

See notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	\$ 3,522	\$ 2,215	\$ 9,773	\$ 8,205
Costs and operating expenses:				
Cost of revenues	2,359	1,524	6,186	5,879
Research and development expenses	274	366	874	1,258
Selling and marketing expenses	467	424	1,520	1,546
General and administrative expenses	366	407	1,042	775
Accrual for commercial rent tax	-	-	-	300
Depreciation and amortization	39	36	109	141
Total costs and operating expenses	3,505	2,757	9,731	9,899
Income (loss) from operations	17	(542)	42	(1,694)
Interest expense, net	416	329	1,332	761
Loss before income taxes	(399)	(871)	(1,290)	(2,455)
Income taxes	2	1	6	9
Net loss	\$ (401)	\$ (872)	\$ (1,296)	\$ (2,464)
Net loss per share – basic and diluted	\$ (0.01)	\$ (0.01)	\$ (0.02)	\$ (0.03)
Basic and diluted weighted average number of shares outstanding	72,273,525	72,273,525	72,273,525	72,273,525

See notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net loss for the period	\$ (1,296)	\$ (2,464)
Adjustments to reconcile loss for the period to net cash provided by (used in) operating activities:		
Accumulated interest on short-term loan	268	154
Depreciation and amortization	109	141
Amortization related to convertible notes	782	507
Tax provision	-	(158)
Stock-based compensation	98	266
Accrual for commercial rent tax	-	300
Provision for losses on accounts receivable	-	146
Decrease in liability for severance pay, net	(13)	(31)
Exchange rates differences on deposits, net	1	2
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(205)	247
(Increase) decrease in prepaid expenses and other current assets	(8)	16
Increase in inventory	(1)	(6)
Increase (decrease) in accounts payable	134	(220)
Increase (decrease) in deferred revenues	154	(144)
Increase (decrease) in other current liabilities	27	(766)
	1,346	454
Net cash provided by (used in) operating activities	<u>50</u>	<u>(2,010)</u>
Cash flows from investing activities:		
Purchase of property and equipment	(56)	(99)
Release of restricted cash and short-term investment, net	80	32
Net cash provided by (used in) investing activities	<u>24</u>	<u>(67)</u>
Cash flows from financing activities:		
Payment of capital leases	-	(7)
Short-term loan from a related party	-	2,000
Net cash provided by financing activities	<u>-</u>	<u>1,993</u>
Increase (decrease) in cash and cash equivalents	74	(84)
Cash and cash equivalents at beginning of period	214	308
Cash and cash equivalents at end of period	<u>\$ 288</u>	<u>\$ 224</u>

	Nine Months Ended September 30,	
	2012	2011
Supplemental schedule of cash flow information:		
Cash paid for:		
Interest on short-term loan from a related party	140	-
Taxes	245	47
Total	\$ 385	\$ 47

See notes to unaudited condensed consolidated financial statements.

DELTATHREE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Basis of Presentation

Financial Statement Preparation

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

The results for the interim periods presented are not necessarily indicative of the results that may be expected for any future period. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2011, included in our Annual Report on Form 10-K filed with the SEC on March 28, 2012, our Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the SEC on May 14, 2012, our Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, filed with the SEC on August 13, 2012, and all of our other periodic filings, including Current Reports on Form 8-K, filed with the SEC after the end of our 2011 fiscal year and through the date of this Report.

Going Concern

The Company has sustained significant operating losses in recent periods, which has resulted in a significant reduction in its cash reserves. The Company and its subsidiaries have entered into four loan agreements with D4 Holdings, LLC, its majority stockholder, pursuant to which D4 Holdings has agreed to provide the Company with loans in the aggregate principal amount of \$4,100,000. The initial Loan and Security Agreement, or the “First Loan Agreement”, was entered into on March 1, 2010, and the Company has drawn the maximum principal amount available under the First Loan Agreement. On August 10, 2010, the Company and its subsidiaries entered into the Second Loan and Security Agreement, or the “Second Loan Agreement”, with D4 Holdings with a maximum principal amount of \$1,000,000, and the Company has drawn the maximum principal amount available under the Second Loan Agreement. In connection with the Second Loan Agreement, the Company issued D4 Holdings a warrant to purchase up to 4,000,000 shares of the Company's common stock at an exercise price of \$0.1312 per share. On March 2, 2011, the Company and its subsidiaries entered into the Third Loan and Security Agreement, or the “Third Loan Agreement”, with D4 Holdings, pursuant to which D4 Holdings agreed to provide the Company and its subsidiaries an additional line of credit in a principal amount of \$1,600,000. Pursuant to the terms of the Convertible Promissory Note, or the “Convertible Note”, issued by the Company in connection with the Third Loan Agreement, D4 Holdings may elect to convert all or any portion of the outstanding principal amount under the Convertible Note into that number of shares of the Company's common stock determined by dividing such principal amount by \$0.08 (as may be adjusted under the terms of the Convertible Note). Simultaneous with the Company's entering into the Third Loan Agreement, D4 Holdings and the Company entered into an amendment of the First Loan Agreement, pursuant to which (among other things) the maturity date for repayment of principal under the First Loan Agreement was extended from March 1, 2011, to March 1, 2012. The maturity date was subsequently extended by oral agreement of the parties to July 1, 2012, and then subsequently orally extended again to January 2, 2014, pending the parties finalizing and entering into a formal amendment. In connection with the Third Loan Agreement, the Company issued D4 Holdings a warrant to purchase up to 1,000,000 shares of the Company's common stock at an exercise price of \$0.096 per share. The Company has drawn the aggregate principal amount available under the Third Loan Agreement, the principal amount of which can be converted by D4 Holdings into an aggregate of 20,000,000 shares of the Company's common stock. On September 12, 2011, the Company and its subsidiaries entered into the Fourth Loan and Security Agreement, or the “Fourth Loan Agreement”, with D4 Holdings, pursuant to which D4 Holdings agreed to provide the Company and its subsidiaries an additional line of credit in a principal amount of \$300,000. As of September 30, 2012, the Company had drawn down the aggregate amount of \$200,000 from D4 Holdings pursuant to notices of borrowing under the Fourth Loan Agreement.

As of September 30, 2012, the Company had negative working capital equal to approximately \$5.9 million as well as negative stockholders' equity equal to approximately \$5.6 million. The Company believes it is probable that it will continue to experience losses and increased negative working capital and negative stockholders' equity in the near future and may not be able to return to positive cash flow before it requires additional cash (in addition to any further amounts it may borrow from D4 Holdings under the Fourth Loan Agreement) in the near term. The Company may experience difficulties accessing the equity and debt markets and raising additional capital, and there can be no assurance that the Company will be able to raise such additional capital on favorable terms or at all. If additional funds are raised through the issuance of equity securities, the Company's existing stockholders will experience significant further dilution. Because of the Company's significant losses to date and the Company's limited tangible assets, the Company does not fit traditional credit lending criteria, which could make it difficult for the Company to obtain loans or to access the capital markets. If the Company issues additional equity or convertible debt securities to raise funds, the ownership percentage of the Company's existing stockholders would be reduced and they may experience significant dilution. New investors may demand rights, preferences or privileges senior to those of existing holders of the Company's common stock.

Due to the limited availability of additional loan advances under the Fourth Loan Agreement, the Company believes that, unless it is able to increase revenues and generate additional cash flows, its current cash and cash equivalents will not satisfy its current projected cash requirements beyond the foreseeable future. As a result, there is substantial doubt about the Company's ability to continue as a going concern.

In addition, unless the Company is able to increase revenues and generate additional cash flows, based on currently projected cash flows the Company believes that it may be unable to pay future scheduled interest and/or principal payments under the various loan agreements with D4 Holdings as these obligations become due. In the event that were to occur, if D4 Holdings is not willing to waive compliance or otherwise modify the Company's obligations such that the Company is able to avoid defaulting on such obligations, D4 Holdings could accelerate the maturity of the Company's debts due to it. Further, because D4 Holdings has a lien on all of the Company's assets to secure the Company's obligations under the loan agreements, D4 Holdings could take actions under the loan agreements and seek to take possession of or sell the Company's assets to satisfy the Company's obligations thereunder. Any of these actions would likely have an immediate material adverse effect on the Company's business, financial condition or results of operations.

Due to the Company's ongoing losses and reduction in cash, the Company initiated restructuring activities beginning in the second quarter of 2011 in an effort to cut operating costs significantly and better align the Company's operations with its current business model. In accordance with the restructuring, the Company instituted a reduction in force and decreased the number of full time employees from approximately 53 to 37, reduced the salaries of all remaining employees by five percent, and decreased non-material expenses as well as payments to be made to vendors and other third parties. As of September 30, 2012, the Company had 23 full time employees.

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

Use of Estimates

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

Concentration of Credit and Business Risks

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

Sales to material customers for each of the three months ended September 30, 2012 and 2011, and accounts receivable as of September 30, 2012, and December 31, 2011, were as follows:

Customer	Revenues		Accounts Receivable	
	Three Months Ended September 30,		As of	
	2012	2011	September 30, 2012	December 31, 2011
Reseller A	44%	-	38%	-
Reseller B	9%	35%	14%	19%
Affiliate A	10%	-	-	-
Affiliate B	7%	13%	-	-
Service Provider A	5%	11%	21%	38%

Earnings per Common Share

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

2. Stock-Based Compensation

Options

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

The Company has no awards with market or performance conditions.

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

Options to purchase 400,000 shares of the Company's common stock were granted during the three months ended September 30, 2012.

3. Commitments and Contingencies

Lease Commitments

The Company leases its executive offices at 26 Avenue at Port Imperial, West New York, New Jersey, and storage and equipment space at 117 Central Avenue, Hackensack, New Jersey. The Company leases each of these facilities on a month-to-month basis. The aggregate rent expense, net, for the two locations for the three months ended September 30, 2012, was \$3,150.

Delta Three Israel Ltd., a wholly-owned subsidiary of the Company (the "Subsidiary"), leases an office that houses the Company's research and development facilities in Jerusalem, Israel. The term of the lease is until June 30, 2015. Rent expense, net for the Subsidiary for the three months ended September 30, 2012, was \$36,750.

Legal Proceedings

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

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

Regulatory Taxes, Fees and Surcharges

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

The Company paid approximately \$245,000 of state and local taxes and other fees during the three months ended September 30, 2012. To the extent the Company increases the cost of services to our customers to recoup some of the costs of compliance this will have the effect of decreasing any price advantage the Company may have over traditional telecommunications companies.

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

4. Warrants and Convertible Note

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

5. Subsequent Events

On November 13, 2012, each of the Company, the Subsidiary and DME Solutions, Inc. entered into the Third Amendment to Loan and Security Agreements, or the "Third Amendment", and the Amendment to Warrant Agreements, or the "Warrants Amendment", with D4 Holdings. Pursuant to the Third Amendment and the Warrants Amendment,

- the maturity date for repayment of principal and interest under the First Loan Agreement was extended to January 2, 2014;
- the maturity date for repayment of principal and interest under the Second Loan Agreement was extended to January 2, 2015;
- the maturity date for repayment of principal and interest under each of the Third and Fourth Loan Agreements was extended to January 2, 2016; and
- the exercise price under each of the Warrant Agreements entered into by the Company and D4 Holdings as of February 12, 2009, August 10, 2010, and March 2, 2011 was amended to \$0.02 per share.

In connection with the extension of the maturity dates under the Third Amendment, the Company issued to D4 Holdings a Warrant, or together with the Third Amendment and the Warrants Amendment, the "Transaction Documents", exercisable for ten years, to purchase up to 10,000,000 shares of common stock of the Company at an exercise price of \$0.02 per share.

The Company is majority-owned by D4 Holdings. The ultimate ownership of D4 Holdings includes owners of ACN, Inc. Each of Robert Stevanovski, Anthony Cassara and David Stevanovski, members of the Company's Board of Directors, is a principal of D4 Holdings. As a result, each of these individuals and may be deemed to have a direct or indirect interest in the transactions contemplated by the Transaction Documents. In accordance with the Company's Audit Committee Charter, the Transaction Documents and the transactions contemplated thereby were approved by the Audit Committee, which includes those directors who are not affiliated with D4 Holdings.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and the Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are based on current expectations, estimates, forecasts and projections about us, our future performance, the industries in which we operate our beliefs and our management's assumptions. In addition, other written or oral statements that constitute forward-looking statements may be made by us or on our behalf. Words such as "may," "expect," "anticipate," "forecast," "intend," "plan," "believe," "seek," "estimate," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to assess. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. These risks and uncertainties include, but are not limited to, the following:

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

For a more complete list and description of such risks and uncertainties, as well as other risks, please refer to the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the SEC on March 28, 2012, as updated in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the SEC on May 14, 2012, and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, filed with the SEC on August 13, 2012. Except as required under the federal securities laws and the rules and regulations promulgated thereunder, we do not have any intention or obligation to update publicly any forward-looking statements or risk factors after the filing of this report, whether as a result of new information, future events, changes in assumptions or otherwise.

Overview

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

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

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

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

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

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

On April 3, 2012, we entered into an amendment to our sales agency agreement with ACN and our introducer agreement with ACN Europe. Pursuant to the terms of the amendment, beginning April 1, 2012, we are required to pay all then-current commissions on a timely basis as required under the agreements and a late fee in the amount of one percent per month of any past-due, unpaid commissions (which, as of September 30, 2012, was equal to approximately \$943,000). In addition, beginning July 15, 2012, we are required to pay down any unpaid past due amounts in an amount equal to at least \$15,000 per month through June 15, 2013, and at least \$25,000 per month thereafter until such time as the unpaid balance is paid in full, and are required to pay in full any unpaid, past due amounts upon 30 days' notice. In July 2012 we began making the \$15,000 monthly payment. In addition, in the event of certain insolvency-related events defined in the agreements, all unpaid amounts will become immediately due and payable effective immediately prior to such event.

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

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

Going forward, we expect to:

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

As of September 30, 2012, we had negative working capital equal to approximately \$5.9 million as well as negative stockholders' equity equal to approximately \$5.6 million. We believe it is probable that we will continue to experience losses and increased negative working capital and negative stockholders' equity in the near future and may not be able to return to positive cash flow before we require additional cash (in addition to any further amounts we may borrow from D4 Holdings under the Fourth Loan Agreement) in the near term. We may experience difficulties accessing the equity and debt markets and raising additional capital, and there can be no assurance that we will be able to raise such additional capital on favorable terms or at all. If additional funds are raised through the issuance of equity securities, our existing stockholders will experience significant further dilution. Because of our significant losses to date and our limited tangible assets, we do not fit traditional credit lending criteria, which could make it difficult for us to obtain loans or to access the capital markets. If we issue additional equity or convertible debt securities to raise funds, the ownership percentage of our existing stockholders would be reduced and they may experience significant dilution. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock.

Due to the limited availability of additional loan advances under the Fourth Loan Agreement, we believe that, unless we are able to increase revenues and generate additional cash flows, our current cash and cash equivalents will not satisfy our current projected cash requirements beyond the foreseeable future. As a result, there is substantial doubt about our ability to continue as a going concern.

In addition, unless we are able to increase revenues and generate additional cash flows, based on currently projected cash flows we believe that we may be unable to pay future scheduled interest and/or principal payments under the various loan agreements with D4 Holdings as these obligations become due. In the event that were to occur, if D4 Holdings is not willing to waive compliance or otherwise modify our obligations such that we are able to avoid defaulting on such obligations, D4 Holdings could accelerate the maturity of our debts due to it. Further, because D4 Holdings has a lien on all of our assets to secure our obligations under the loan agreements, D4 Holdings could take actions under the loan agreements and seek to take possession of or sell our assets to satisfy our obligations thereunder. Any of these actions would likely have an immediate material adverse effect on our business, financial condition or results of operations.

Due to our ongoing losses and reduction in cash, we initiated restructuring activities beginning in the second quarter of 2011 in an effort to cut operating costs significantly and better align our operations with our current business model. In accordance with the restructuring, we instituted a reduction in force and decreased the number of full time employees from approximately 53 to 37, reduced the salaries of all remaining employees by five percent, and decreased non-material expenses as well as payments to be made to vendors and other third parties. As of September 30, 2012, we had 23 full time employees.

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

Trends in Our Industry and Business

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

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

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

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

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

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

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

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

Risk Factors: For a discussion of the impact of market risks, financial risks and other risks and uncertainties that we face, see "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the SEC on March 28, 2012, as updated in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the SEC on May 14, 2012, and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, filed with the SEC on August 13, 2012.

Revenues

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

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

The following sets forth our revenues per segment for the three month and nine months ended September 30, 2012 and 2011:

Segment	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(\$ in thousands)		(\$ in thousands)	
Reseller	\$ 2,163	\$ 1,278	\$ 5,447	\$ 5,383
Direct-to-consumer	989	622	3,223	1,637
Service provider	294	286	872	1,093
Other	76	29	231	92
Total Revenues	\$ 3,522	\$ 2,215	\$ 9,773	\$ 8,205

The provision of video and voice-over-IP products and services through our reseller, direct-to-consumer and service provider channels accounted for approximately 61.4% and 28.1%, 8.3% and 57.7%, and 28.0% and 12.9%, respectively of our total revenues for the three months ended September 30, 2012 and 2011.

Costs and Operating Expenses

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

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

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

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

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

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

We have not recorded any income tax benefit for net losses and credits incurred for any period from inception to September 30, 2012. The utilization of these losses and credits depends on our ability to generate taxable income in the future. Because of the uncertainty of our generating taxable income going forward, we have recorded a full valuation allowance with respect to these deferred assets.

Net Operating Losses

As of September 30, 2012, we had net operating losses, or NOLs, generated in the U.S. of approximately \$23.0 million and Delta Three Israel Ltd., our wholly-owned subsidiary, had NOLs of approximately \$5.0 million. Our issuance of common stock to D4 Holdings in February 2009 constituted an "ownership change" as defined in Section 382 of the Internal Revenue Code. As a result, under Section 382 our ability to utilize NOLs generated in the U.S. prior to February 2009 (equal to approximately \$156 million) to offset any income we may generate in the future will be limited to approximately \$600,000 per year from February 2009. The NOLs began to expire in 2011 and will continue to expire at various dates until 2029 if not utilized. Our ability to utilize our remaining NOLs could be additionally reduced if we experience any further "ownership change," as defined under Section 382.

Results of Operations - Three Months Ended September 30, 2012, Compared to Three Months Ended September 30, 2011

Revenues

Revenues increased by approximately \$1.3 million, or 59%, to approximately \$3.5 million for the three months ended September 30, 2012, from approximately \$2.2 million for the three months ended September 30, 2011. During this period the number of minutes carried by our network decreased by approximately 6% from approximately 93 million minutes during the three months ended September 30, 2011, to approximately 87 million minutes for the corresponding period in 2012. This was caused, in large part, by a decrease of approximately 26 million minutes utilized by our second-largest reseller during the three months ended September 30, 2012, compared to the number of minutes utilized by such reseller during the corresponding period in 2011. This decrease was partially offset by an increase in the number of minutes utilized by our largest reseller for which we terminated a large number of calls to higher-rate destinations during this period, as this reseller resumed conducting business with us in September 2011 following a period from February 2011 in which the operations of this reseller were suspended. In addition, despite the overall decrease in the number of minutes carrier by our network our revenue increased during this period due to an increase in revenue in our direct-to-consumer division, as the gross margins from such division are significantly higher than the gross margins generated by our reseller division.

Revenues generated by our reseller division increased by approximately \$885,000, or 69%, to approximately \$2.2 million for the three months ended September 30, 2012, from approximately \$1.3 million for the three months ended September 30, 2011. This increase was caused in large part by our largest reseller resuming conducting business with us in September 2011 following a period from February 2011 in which the operations of this reseller were suspended. Our two largest resellers accounted for approximately \$1.9 million, or approximately 87%, of the revenue generated from our reseller division for the three months ended September 30, 2012, which represented approximately 53% of our total revenue for such period. By comparison, for the three months ended September 30, 2011, our two largest resellers accounted for approximately 70% of the revenue generated from our reseller division, or approximately 41% of our total revenue during such period.

Revenues generated by our service provider division increased by approximately \$8,000, or 3%, from approximately \$286,000 for the three months ended September 30, 2011, to approximately \$294,000 for the three months ended September 30, 2012. This increase was due to a one-time set-up fee we received from a service provider during the three months ended September 30, 2012.

Sales to direct consumers increased by approximately \$367,000, or 59%, to approximately \$989,000 for the three months ended September 30, 2012, from approximately \$622,000 for the three months ended September 30, 2011. Revenues generated through our iConnectHere offering declined by approximately \$77,000 from approximately \$215,000 for the three months ended September 30, 2011, to approximately \$138,000 for the three months ended September 30, 2012. This was offset by the revenues generated by our joip Mobile offering, which increased from \$389,000 for the three months ended September 30, 2011, to approximately \$843,000 for the three months ended September 30, 2012, primarily as a result of the sales agency agreement we entered into with ACN, the introducer agreement we entered into with ACN Europe and the sales agreement we entered into with Momentis.

Costs and Operating Expenses

Cost of revenues. Cost of revenues increased by approximately \$835,000, or 55%, from approximately \$1.5 million for the three months ended September 30, 2011, to approximately \$2.4 million for the three months ended September 30, 2012. Our network rent cost decreased slightly by approximately \$33,000 from approximately \$298,000 for the three months ended September 30, 2011, to approximately \$265,000 for the three months ended September 30, 2012. Our termination cost increased by approximately \$883,000, or 81%, from approximately \$1.1 million for the three months ended September 30, 2011, to approximately \$2.0 million for the three months ended September 30, 2012. The main reason for the increase in termination cost was the resumption of operations of our largest reseller during September 2011, which generated approximately \$1.4 million of total termination costs for the three months ended September 30, 2012, partially offset by a decline in the total termination costs of our second-largest reseller of approximately \$340,000 during this period. In addition, during this period our largest reseller utilized minutes through our network that were more expensive for us to purchase than the minutes that were utilized by our second-largest reseller during this period.

Research and development expenses. Research and development expenses decreased by approximately \$92,000, or 25%, from approximately \$366,000 for the three months ended September 30, 2011, to approximately \$274,000 for the three months ended September 30, 2012. The main reason for the decrease was the reduction in the number of employees in our research and development department. As a percentage of revenues, research and development expenses for the three months ended September 30, 2012, was approximately 8% compared to approximately 17% for the three months ended September 30, 2011.

Selling and marketing expenses. Selling and marketing expenses increased by approximately \$43,000, or 10%, to approximately \$467,000 for the three months ended September 30, 2012, from approximately \$424,000 for the three months ended September 30, 2011. The main reason for the increase was an increase in commissions recorded for ACN, ACN Europe and Momentis, offset by a reduction in the number of employees in our sales and marketing department. As a percentage of revenues, selling and marketing expenses decreased to approximately 13% for the three months ended September 30, 2012, from approximately 19% for the three months ended September 30, 2011.

General and administrative expenses. General and administrative expenses decreased by approximately \$41,000, or 10%, to approximately \$366,000 for the three months ended September 30, 2012, from approximately \$407,000 for the three months ended September 30, 2011. During the three months ended September 30, 2011, we recorded a credit of \$50,000 as a reverse for losses on accounts receivable in connection with outstanding amounts owed to us by our then-largest reseller. Excluding this one-time item, our general and administrative expenses would have decreased in the three months ended September 30, 2012, by approximately \$91,000 from the three months ended September 30, 2011, primarily due to a reduction in salaries as a result of our restructuring as well as a reduction in payments to be made to our vendors and other third parties.

Depreciation and amortization. Depreciation and amortization increased by approximately \$3,000, or 8%, from approximately \$36,000 for the three months ended September 30, 2011, to approximately \$39,000 for the three months ended September 30, 2012. This was caused by an acquisition of fixed assets during this period.

Income (Loss) from Operations

For the three months ended September 30, 2012, we recorded income from operations of approximately \$17,000 compared to a loss from operations of approximately \$542,000 for the three months ended September 30, 2011, due to the factors set forth above.

Interest Expense, Net

We recorded interest expense of approximately \$416,000 for the three months ended September 30, 2012, compared to approximately \$329,000 for the three months ended September 30, 2011. This increase was due primarily to interest paid and recorded under our loan agreements with D4 Holdings of approximately \$140,000, and \$261,000 we recorded for the warrant we issued to D4 Holdings in connection with the Second Loan Agreement and the warrant and Convertible Note we issued to D4 Holdings in connection with the Third Loan Agreement.

Income Taxes, Net

We recorded net income tax expenses of \$2,000 for the three months ended September 30, 2012, compared to \$1,000 for the three months ended September 30, 2011.

Net Loss

For the three months ended September 30, 2012, we recorded a net loss of approximately \$401,000 compared to a net loss of approximately \$872,000 for the three months ended September 30, 2011, due to the factors set forth above.

Results of Operations - Nine Months Ended September 30, 2012, Compared to Nine Months Ended September 30, 2011

Revenues

Revenues increased by approximately \$1.6 million, or 20%, to approximately \$9.8 million for the nine months ended September 30, 2012, from approximately \$8.2 million for the nine months ended September 30, 2011. During this period the number of minutes carried by our network decreased by approximately 10% from approximately 279 million minutes during the nine months ended September 30, 2011, to approximately 255 million minutes for the corresponding period in 2012. This was caused, in large part, by a decrease of approximately 52 million minutes utilized by our second-largest reseller during the nine months ended September 30, 2012, compared to the number of minutes utilized by such reseller during the corresponding period in 2011. This decrease was partially offset by an increase in the number of minutes from our largest reseller for which we terminated a large number of calls to higher-rate destinations during this period, as this reseller resumed conducting business with us in September 2011 following a period from February 2011 in which the operations of this reseller were suspended. In addition, despite the overall decrease in the number of minutes carrier by our network our revenue increased during this period due to an increase in revenue in our direct-to-consumer division, as the gross margins from such division are significantly higher than the gross margins generated by our reseller division.

Revenues generated by our reseller division were approximately \$5.4 million for both of the nine months ended September 30, 2012 and 2011, although the revenues generated by division for the nine months ended September 30, 2012, reflected an increase in each subsequent quarter. Our two largest resellers accounted for approximately \$4.4 million, or approximately 81%, of the revenue generated from our reseller division for the nine months ended September 30, 2012, which represented approximately 45% of our total revenue for such period. By comparison, for the nine months ended September 30, 2011, our two largest resellers accounted for approximately \$3.9 million, or approximately 72%, of the revenue generated from our reseller division, or approximately 47% of our total revenue during such period.

Revenues generated by our service provider division decreased by approximately \$221,000, or 21%, from approximately \$1.1 million for the nine months ended September 30, 2011, to approximately \$872,000 for the nine months ended September 30, 2012. This decrease was due to one-time set-up fees we received from three different service providers during the nine months ended September 30, 2011.

Sales to direct consumers increased by approximately \$1.6 million, or 100%, to approximately \$3.2 million for the nine months ended September 30, 2012, from approximately \$1.6 million for the nine months ended September 30, 2011. Revenues generated through our iConnectHere offering declined by approximately \$234,000 from approximately \$700,000 for the nine months ended September 30, 2011, to approximately \$466,000 for the nine months ended September 30, 2012. This was offset by the revenues generated by our joip Mobile offering, which increased from \$874,000 for the nine months ended September 30, 2011, to approximately \$2.7 million for the nine months ended September 30, 2012, primarily as a result of the sales agency agreement we entered into with ACN, the introducer agreement we entered into with ACN Europe and the sales agreement we entered into with Momentis.

Costs and Operating Expenses

Cost of revenues. Cost of revenues decreased by approximately \$300,000, or 5%, from approximately \$5.9 million for the nine months ended September 30, 2011, to approximately \$6.2 million for the nine months ended September 30, 2012. Our network rent cost decreased by approximately \$109,000, or 13%, from approximately \$891,000 for the nine months ended September 30, 2011, to approximately \$782,000 for the nine months ended September 30, 2012, and our termination cost increased by approximately \$518,000, or 11%, from approximately \$4.5 million for the nine months ended September 30, 2011 to approximately \$5.0 million for the nine months ended September 30, 2012. The main reason for the increase in termination costs was the resumption of operations of our largest reseller during September 2011, which utilized minutes through our network that were most expensive for us to purchase than the minutes that were utilized by our second-largest reseller during the nine months ended September 30, 2012.

Research and development expenses. Research and development expenses decreased by approximately \$384,000, or 31%, from approximately \$1.3 million for the nine months ended September 30, 2011, to approximately \$874,000 for the nine months ended September 30, 2012. The main reason for the decrease was the reduction in the number of employees in our research and development department. As a percentage of revenues, research and development expenses for the nine months ended September 30, 2012, was approximately 9% compared to approximately 15% for the nine months ended September 30, 2011.

Selling and marketing expenses. Selling and marketing expenses remained constant at approximately \$1.5 million for the nine months ended September 30, 2012 and 2011. During the nine months ended September 30, 2012 there was a reduction in the number of employees in our sales and marketing department and a corresponding reduction in expenses, offset by an increase in commissions paid to ACN, ACN Europe and Momentis. As a percentage of revenues, selling and marketing expenses decreased to approximately 16% for the nine months ended September 30, 2012, from approximately 19% for the nine months ended September 30, 2011.

General and administrative expenses. General and administrative expenses increased by approximately \$267,000, or 34% to approximately \$1.0 million for the nine months ended September 30, 2012, from approximately \$775,000 for the nine months ended September 30, 2011. During the nine months ended September 30, 2011, we recorded a one-time reversal of an accrual of \$706,000 for expenses expected to arise from our litigation with Centre One and a one-time reversal of an accrual for tax liability of \$158,000 that was recorded. This was partially offset by \$146,000 we recorded in 2011 as a provision for losses on accounts receivable in connection with outstanding amounts owed to us by our largest reseller. Excluding these one-time items, our general and administrative expenses would have decreased in the nine months ended September 30, 2012, by approximately \$451,000 from the nine months ended September 30, 2011, primarily due to a reduction in salaries arising from our restructuring as well as a reduction in payments to be made to our vendors and other third parties.

Accrual for commercial rent tax. As discussed below under – "Liquidity and Capital Resources", on July 5, 2011, we received a notice from the New York City Department of Finance, which claimed that we had not paid commercial rent tax required under the New York City Administrative Code from June 1998 through May 2008 for the two offices that we had leased during that time. The notice stated that we are obligated to pay the outstanding tax amounts, as well as significant interest and penalties that were assessed on the unpaid amounts as well as for the failure to file the applicable tax returns. For the nine months ended September 30, 2011, we recorded \$300,000 as a provision for tax liability.

Depreciation and amortization. Depreciation and amortization decreased by approximately \$32,000, or 23%, from approximately \$141,000 for the nine months ended September 30, 2011, to approximately \$109,000 for the nine months ended September 30, 2012. This was caused by a decline in the value of our fixed assets during this period.

Income (Loss) from Operations

For the nine months ended September 30, 2012, we recorded income from operations of approximately \$42,000 compared to a loss from operations of approximately \$1.7 million for the nine months ended September 30, 2011, due to the factors set forth above.

Interest Expense, Net

We recorded interest expense of approximately \$1.3 million for the nine months ended September 30, 2012, compared to approximately \$761,000 for the nine months ended September 30, 2011. This increase was due primarily to interest recorded under our loan agreements with D4 Holdings of approximately \$408,000, and the expense equal to \$782,000 we recorded for the warrant we issued to D4 Holdings in connection with the Second Loan Agreement and the warrant and Convertible Note we issued to D4 Holdings in connection with the Third Loan Agreement.

Income Taxes, Net

We recorded net income tax expenses of \$6,000 for the nine months ended September 30, 2012, compared to \$9,000 for the nine months ended September 30, 2011.

Net Loss

For the nine months ended September 30, 2012, we recorded a net loss of approximately \$1.3 million compared to a net loss of approximately \$2.5 million for the nine months ended September 30, 2011, due to the factors set forth above.

Liquidity and Capital Resources

Since our inception in June 1996, we have incurred significant operating and net losses due in large part to the start-up and development of our operations and our losses from operations. For the nine months ended September 30, 2012, we recorded net income from operations of approximately \$42,000 compared to a net loss from operations of approximately \$1.7 million for the nine months ended September 30, 2011. To date, we have an accumulated deficit of approximately \$182.6 million.

As of September 30, 2012, we had cash and cash equivalents of approximately \$288,000 and restricted cash and short-term investments of approximately \$272,000, or a total of cash, cash equivalents and restricted cash of \$560,000, a decrease of approximately \$6,000 from December 31, 2011. The increase in cash and cash equivalents (excluding the restricted cash and short-term investments) was primarily caused by net cash provided by operating activities of approximately \$50,000 during the nine months ended September 30, 2012, and by net cash used in investing activity of purchasing new equipment of approximately \$56,000 during the nine months ended September 30, 2012.

Cash used in or provided by operating activities is net loss adjusted for certain non-cash items and changes in assets and liabilities. We had positive cash flow from operating activities of approximately \$50,000 and negative cash flow from operating activities of approximately \$2.0 million during the nine months ended September 30, 2012 and 2011, respectively. The increase in our cash generated from operating activities was primarily due to a decrease in our net loss of \$1.2 million, accumulated interest on short-term loans of \$269,000, amortization of \$782,000 related to convertible notes and an increase in deferred revenues of \$154,000, offset by an increase in accounts receivables of \$205,000.

Net cash used in or provided by investing activities is generally driven by our capital expenditures and changes in our short and long-term investments. For the nine months ended September 30, 2012, we expensed \$56,000 for purchases of new equipment, compared to \$99,000 for the nine months ended September 30, 2011. In addition, during the nine months ended September 30, 2012, restricted cash equal to \$131,000 that was underlying the letter of credit previously provided by us to the landlord of our subsidiary's office in Jerusalem was released, since such letter of credit is no longer required under the extension of the lease that we executed during this period. During the nine months ended September 30, 2012, a reserve of \$242,000 was temporarily held back by our previous payment processor pending the final calculation and clearance of all payments processed by such third party.

Net cash used in or provided by financing activities is generally driven by drawing down amounts available under lines of credit available to us, issuing shares of our capital stock and receiving cash that we had previously pledged or otherwise deposited as security for our lenders and creditors. For the nine months ended September 30, 2012, we did not draw down any amounts under our loan agreements with D4 Holdings.

Financing cash flows have historically consisted primarily of payments of capital leases and proceeds from the exercise of options we have granted to our employees and directors. In February 2009 we consummated a transaction with D4 Holdings pursuant to which we sold to D4 Holdings an aggregate of 39,000,000 shares of our common stock and a warrant to purchase up to an additional 30,000,000 shares of our common stock for an aggregate purchase price of \$1,200,000. In addition, on March 1, 2010, we and our subsidiaries entered into the First Loan Agreement with D4 Holdings pursuant to which D4 Holdings agreed to provide us and our subsidiaries a line of credit in a principal amount of \$1,200,000. On August 10, 2010, we and our subsidiaries entered into the Second Loan Agreement with D4 Holdings, pursuant to which D4 Holdings agreed to provide us and our subsidiaries an additional line of credit in a principal amount of \$1,000,000. In connection with the Second Loan Agreement, we issued D4 Holdings a warrant to purchase up to 4,000,000 shares of our common stock at an exercise price of \$0.1312 per share. We have drawn down all amounts available to be borrowed under the first two lines of credit. On March 2, 2011, we and our subsidiaries entered into the Third Loan Agreement with D4 Holdings pursuant to which D4 Holdings agreed to provide us and our subsidiaries an additional line of credit in a principal amount of \$1,600,000. Pursuant to the terms of the Convertible Note we issued to D4 Holdings in connection with the Third Loan Agreement, D4 Holdings may elect to convert all or any portion of the outstanding principal amount under the Convertible Note into that number of shares of our common stock determined by dividing such principal amount by \$0.08 (as may be adjusted under the terms of the Convertible Note). Simultaneous with our entering into the Third Loan Agreement, D4 Holdings and we entered into an amendment of the First Loan Agreement pursuant to which (among other things) the maturity date for repayment of principal under the First Loan Agreement was extended from March 1, 2011, to March 1, 2012. The maturity date was subsequently extended by oral agreement of the parties to July 1, 2012, and then subsequently orally extended again to January 2, 2014, pending the parties finalizing and entering into a formal amendment. In connection with the Third Loan Agreement, we issued D4 Holdings a warrant to purchase up to 1,000,000 shares of our common stock at an exercise price of \$0.096 per share. We have drawn down the aggregate principal amount available under the Third Loan Agreement, the principal amount of which can be converted by D4 Holdings into an aggregate of 20,000,000 shares of our common stock. On September 12, 2011, we and our subsidiaries entered into the Fourth Loan Agreement with D4 Holdings, pursuant to which D4 Holdings agreed to provide us and our subsidiaries an additional line of credit in a principal amount of \$300,000. As of September 30, 2012, we have drawn down the aggregate amount of \$200,000 from D4 Holdings pursuant to notices of borrowing under the Fourth Loan Agreement.

On November 13, 2012, each of us, our subsidiary and DME Solutions, Inc. entered into the Third Amendment to Loan and Security Agreements, or the "Third Amendment", and the Amendment to Warrant Agreements, or the "Warrants Amendment", with D4 Holdings. Pursuant to the Third Amendment and the Warrants Amendment,

- the maturity date for repayment of principal and interest under the First Loan Agreement was extended to January 2, 2014;
- the maturity date for repayment of principal and interest under the Second Loan Agreement was extended to January 2, 2015;
- the maturity date for repayment of principal and interest under each of the Third and Fourth Loan Agreements was extended to January 2, 2016; and
- the exercise price under each of the Warrant Agreements entered into by the Company and D4 Holdings as of February 12, 2009, August 10, 2010, and March 2, 2011 was amended to \$0.02 per share.

In connection with the extension of the maturity dates under the Third Amendment, we issued to D4 Holdings a Warrant, or together with the Third Amendment and the Warrants Amendment, the "Transaction Documents", exercisable for ten years, to purchase up to 10,000,000 shares of our common stock at an exercise price of \$0.02 per share.

There were no options exercised by our employees or directors during the nine months ended September 30, 2012. For the nine months ended September 30, 2011, we paid \$7,000 for capital leases. We did not record any expenses for capital leases during the nine months ended September 30, 2012.

On July 5, 2011, we received a notice from the New York City Department of Finance that claimed that we had not paid commercial rent tax required under the New York City Administrative Code from June 1998 through May 2008 for the two offices that we had leased during that time. The notice stated that we are obligated to pay the outstanding tax amounts, as well as significant interest and penalties that were assessed on the unpaid amounts as well as for the failure to file the applicable tax returns. On August 15, 2011, we filed a response contesting the assessment and/or attempting to negotiate a reduction in the amounts to be paid. Our appeal was rejected in July 2012 by an examiner in the Department of Finance, and we have subsequently engaged and begun discussions with a manager in the Department of Finance and submitted additional supporting materials. The final outcome of this assessment and our negotiations with the New York City Department of Finance cannot be determined at this time. In the event that we are required to pay all or most of the amounts claimed by the New York City Department of Finance this would have a material adverse effect on our financial condition and liquidity. During 2011 we recorded \$300,000 as a provision for commercial rent tax.

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

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

On April 3, 2012, we entered into an amendment to our sales agency agreement with ACN and our introducer agreement with ACN Europe. Pursuant to the terms of the amendment, beginning April 1, 2012, we are required to pay all then-current commissions on a timely basis as required under the agreements and a late fee in the amount of one percent per month of any past-due, unpaid commissions (which, as of September 30, 2012, was equal to approximately \$943,000). In addition, beginning July 15, 2012, we are required to pay down any unpaid past due amounts in an amount equal to at least \$15,000 per month through June 15, 2013, and at least \$25,000 per month thereafter until such time as the unpaid balance is paid in full, and are required to pay in full any unpaid, past due amounts upon 30 days' notice. In July 2012 we began making the \$15,000 monthly payment. In addition, in the event of certain insolvency-related events defined in the agreements, all unpaid amounts will become immediately due and payable effective immediately prior to such event.

As of September 30, 2012, we had negative working capital equal to approximately \$5.9 million as well as negative stockholders' equity equal to approximately \$5.6 million. We believe it is probable that we will continue to experience losses and increased negative working capital and negative stockholders' equity in the near future and may not be able to return to positive cash flow before we require additional cash (in addition to any further amounts we may borrow from D4 Holdings under the Fourth Loan Agreement) in the near term. We may experience difficulties accessing the equity and debt markets and raising additional capital, and there can be no assurance that we will be able to raise such additional capital on favorable terms or at all. If additional funds are raised through the issuance of equity securities, our existing stockholders will experience significant further dilution. Because of our significant losses to date and our limited tangible assets, we do not fit traditional credit lending criteria, which could make it difficult for us to obtain loans or to access the capital markets. If we issue additional equity or convertible debt securities to raise funds, the ownership percentage of our existing stockholders would be reduced and they may experience significant dilution. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock.

Due to the limited availability of additional loan advances under the Fourth Loan Agreement, we believe that, unless we are able to increase revenues and generate additional cash, our current cash and cash equivalents will not satisfy our current projected cash requirements beyond the foreseeable future. As a result, there is substantial doubt about our ability to continue as a going concern.

In addition, unless we are able to increase revenues and generate additional cash, based on currently projected cash flows we believe that we may be unable to pay future scheduled interest and/or principal payments under the various loan agreements with D4 Holdings as these obligations become due. In the event that were to occur, if D4 Holdings is not willing to waive compliance or otherwise modify our obligations such that we are able to avoid defaulting on such obligations, D4 Holdings could accelerate the maturity of our debts due to it. Further, because D4 Holdings has a lien on all of our assets to secure our obligations under the loan agreements, D4 Holdings could take actions under the loan agreements and seek to take possession of or sell our assets to satisfy our obligations thereunder. Any of these actions would likely have an immediate material adverse effect on our business, financial condition or results of operations.

Due to our ongoing losses and reduction in cash, we initiated restructuring activities beginning in the second quarter of 2011 in an effort to cut our operating costs significantly and better align our operations with our current business model. In accordance with the restructuring, we instituted a reduction in force and decreased the number of full time employees from approximately 53 to 37, reduced the salaries of all remaining employees by five percent, and decreased our non-material expenses as well as payments to be made to vendors and other third parties. As of September 30, 2012, we had 23 full time employees.

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

Off-Balance Sheet Arrangements

None.

Contingencies

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

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures.

Each of our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, has concluded that, based on such evaluation, our disclosure controls and procedures as of September 30, 2012, were adequate and effective to ensure that material information required to be disclosed by us in the reports that we file and submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in Internal Controls.

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

There have been no material changes to our Legal Proceedings as described in Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the SEC on March 28, 2012.

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

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The information in Part II, Item 5 of this Quarterly Report on form 10-Q is incorporated by reference into this Item 2. The Warrant was issued pursuant to an exemption from registration under the Securities Act of 1933, as amended.

Item 5. Other Information

On November 13, 2012, each of us, our subsidiary and DME Solutions, Inc. entered into the Third Amendment and the Warrants Amendment, with D4 Holdings. Pursuant to the Third Amendment and the Warrants Amendment,

- the maturity date for repayment of principal and interest under the First Loan Agreement was extended to January 2, 2014;
- the maturity date for repayment of principal and interest under the Second Loan Agreement was extended to January 2, 2015;
- the maturity date for repayment of principal and interest under each of the Third and Fourth Loan Agreements was extended to January 2, 2016; and
- the exercise price under each of the Warrant Agreements entered into by the Company and D4 Holdings as of February 12, 2009, August 10, 2010, and March 2, 2011 was amended to \$0.02 per share.

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

Our company is majority-owned by D4 Holdings. The ultimate ownership of D4 Holdings includes owners of ACN, Inc. Each of Robert Stevanovski, Anthony Cassara and David Stevanovski, members of our Board of Directors, is a principal of D4 Holdings. As a result, each of these individuals may be deemed to have a direct or indirect interest in the transactions contemplated by the Transaction Documents. In accordance with the Company's Audit Committee Charter, the Transaction Documents and the transactions contemplated thereby were approved by the Audit Committee, which includes those directors who are not affiliated with D4 Holdings.

Item 6. Exhibits.

See Exhibit Index on page 24 for a description of the documents that are filed as Exhibits to this Quarterly Report on Form 10-Q or incorporated by reference herein.

SIGNATURES

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

DELTATHREE, INC.

Date: November 14, 2012

By: /s/ Effi Baruch
Name: Effi Baruch
Title: Chief Executive Officer, President, Senior Vice President of Operations and Technology and Secretary
(Principal Executive Officer)

Date: November 14, 2012

By: /s/ Yochai Ozeri
Name: Yochai Ozeri
Title: Director of Finance and Treasurer
(Principal Financial Officer)

EXHIBIT INDEX

Exhibit Number	Description
10.1	Third Amendment to Loan and Security Agreements, dated as of November 13, 2012, by and among deltathree, Inc., Delta Three Israel, Ltd. DME Solutions, Inc. and D4 Holdings, LLC.
10.2	Amendment to Warrant Agreements, dated as of November 13, 2012, by and among deltathree, Inc. and D4 Holdings, LLC.
1.03	Warrant, dated November 13, 2012, between deltathree, Inc., and D4 Holdings, LLC.
31.1	Certification of the Principal Executive Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Principal Executive Officer, furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Principal Financial Officer, furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.*
101.SCH	XBRL Taxonomy Extension Schema Document.*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.*

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

**THIRD AMENDMENT TO
LOAN AND SECURITY AGREEMENTS**

THIS THIRD AMENDMENT TO LOAN AND SECURITY AGREEMENTS (this "**Amendment**") is entered into this 13th of November, 2012, by and among (i) deltathree, Inc., a Delaware corporation, Delta Three Israel, Ltd., an Israeli company, and DME Solutions, Inc., a New York corporation (jointly and severally, the "**Borrower**"), and (ii) D4 Holdings, LLC, a Delaware limited liability company ("**Lender**").

RECITALS

A. Lender and Borrower have entered into (i) that certain Loan and Security Agreement dated as of March 1, 2010 (as amended to date and as may be further amended, modified, supplemented or restated, the "**First Loan Agreement**"), (ii) that certain Second Loan and Security Agreement dated as of August 10, 2010 (as amended to date and as may be further amended, modified, supplemented or restated, the "**Second Loan Agreement**"), (iii) that certain Third Loan and Security Agreement dated as of March 2, 2011 (as amended to date and as may be further amended, modified, supplemented or restated, the "**Third Loan Agreement**"), and (iv) that certain Fourth Loan and Security Agreement dated as of September 12, 2011 (as amended to date and as may be further amended, modified, supplemented or restated, the "**Fourth Loan Agreement**"). The First Loan Agreement, the Second Loan Agreement, the Third Loan Agreement and the Fourth Loan Agreement, together with the promissory notes evidencing Borrower's obligations thereunder, are referred to collectively as the "**Existing Loan Agreements**." Lender has extended credit to Borrower for the purposes permitted in the Existing Loan Agreements.

B. Borrower is delinquent in the payment of interest under the Existing Loan Agreements in the aggregate amount of \$549,265, and the individual amount of such delinquent interest payments is set forth for each of the Existing Loan Agreements in Schedule A hereto (such amounts are referred to herein as the "**Delinquent Amounts**"). At the request of Borrower, Lender has agreed to add the Delinquent Amounts to the outstanding principal amount under each respective Existing Loan Agreement as set forth in Schedule A hereto.

C. At the request of Borrower, Lender has agreed to amend the Existing Loan Agreements to extend the maturity date for the repayment of principal thereunder.

D. In partial consideration for the amendment to the Existing Loan Agreements as set forth herein, Borrower has agreed to (i) grant to Lender a warrant to purchase up to 10,000,000 shares of Borrower's common stock and (ii) amend the exercise price of warrants to purchase Borrower's common stock held by Lender.

E. Lender is willing to so amend the Existing Loan Agreements, but only to the extent, in accordance with the terms, subject to the conditions and in reliance upon the representations and warranties set forth below.

AGREEMENT

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

1. Definitions. Capitalized terms used but not defined in this Amendment shall have the meanings given to them in the Existing Loan Agreements.

2. Amendments to Existing Loan Agreements. The Existing Loan Agreements are hereby amended as follows:

2.1 Section 9(k) of the First Loan Agreement is hereby amended to read in its entirety as follows:

“(k) **“Maturity Date”** means January 2, 2014.”

2.2 Section 10(o) of the Second Loan Agreement is hereby amended to read in its entirety as follows:

“(o) **“Maturity Date”** means January 2, 2015.”

2.3 Section 9(n) of the Third Loan Agreement is hereby amended to read in its entirety as follows:

“(n) **“Maturity Date”** means January 2, 2016.”

2.4 Section 9(k) of the Fourth Loan Agreement is hereby amended to read in its entirety as follows:

“(k) **“Maturity Date”** means January 2, 2016.”

3. Delinquent Interest Amounts Added to Principal; Acknowledgment of Loan Balances.

3.1 Effective as of the date of this Amendment, the principal amount owed by Borrower to Lender under each of the Existing Loan Agreements shall be increased by the respective Delinquent Amount set forth on Schedule A hereto.

3.2 Lender hereby waives any event of default under the Existing Loan Agreements arising from the failure of Borrower to timely pay the Delinquent Amounts prior to the date hereof in accordance with the terms of the Existing Loan Agreements.

3.3 Each of Borrower and Lender hereby acknowledge and agree that the outstanding principal amount under each of the Existing Loan Agreements as of the date hereof (before and after giving effect to Section 3.1 hereof) are as set forth on Schedule A hereto.

3.4 Each promissory note evidencing loan advances made pursuant to the Existing Loan Agreements (collectively, the “**Promissory Notes**”) is hereby amended to increase the principal sum thereof to the respective amounts set forth on Schedule A hereto. For purposes of clarification, Lender shall be under no obligation to make loan advances to Borrower in an amount exceeding the Maximum Principal Amount under any Existing Loan Agreement, notwithstanding that foregoing amendment may cause the principal sum of any Promissory Note to exceed the Maximum Principal Amount under such Existing Loan Agreement.

3.5 Each reference in each of the Existing Loan Agreements and their related Promissory Notes to “this Agreement”, “hereunder”, “hereof” or words of like import referring to the respective Existing Loan Agreement and related Promissory Note, shall mean and be a reference to such Existing Loan Agreement or Promissory Note as modified and amended hereby.

4. Limitation of Amendments.

4.1 This Amendment: (a) in no way shall be deemed to be a consent or an agreement on the part of Lender to waive any covenant, liability or obligation of Borrower or any third party or to waive any right, power, or remedy of Lender, except as expressly set forth herein; (b) in no way shall be deemed to imply a willingness on the part of Lender to grant any similar or other future waivers or to agree to any future consents, amendments or modifications to any of the terms and conditions of any of the Existing Loan Agreements; (c) shall not in any way, prejudice, limit, impair or otherwise affect any rights or remedies of Lender under the Existing Loan Agreements; (d) in no way shall obligate Lender to make any future waivers, consents or modifications to any of the Existing Loan Agreements or any other agreement; and (e) is not a continuing waiver with respect to any failure to perform any obligation by Borrower. Nothing in this Amendment shall constitute a satisfaction of Borrower’s obligations under any of the Existing Loan Agreements.

4.2 This Amendment shall be construed in connection with and as part of the Existing Loan Agreements and all terms, conditions, representations, warranties, covenants and agreements set forth in the Existing Loan Agreements, except as herein amended, are hereby ratified and confirmed and shall remain in full force and effect.

4.3 No course of dealing on the part of the Lender or any of its members, officers or representatives, nor any failure or delay in the exercise of any right by Lender, shall operate as a waiver thereof, and any single or partial exercise of any such right shall not preclude any later exercise of any such right. The failure at any time to require strict performance by Borrower of any provision of the Existing Loan Agreements shall not affect any right of Lender thereafter to demand strict compliance and performance.

5. Representations and Warranties. Borrower hereby represents and warrants to Lender as follows:

5.1 Immediately after giving effect to this Amendment (a) the representations and warranties contained in the Existing Loan Agreements are true, accurate and complete in all material respects as of the date hereof (except to the extent such representations and warranties relate to an earlier date, in which case they are true and correct in all material respects as of such date), and (b) no Event of Default has occurred and is continuing;

5.2 Borrower has the power and authority to execute and deliver this Amendment and to perform its obligations under the Existing Loan Agreements, as amended by this Amendment;

5.3 The organizational documents of Borrower delivered to Lender on or before the date of this Amendment remain true, accurate and complete and have not been amended, supplemented or restated and are and continue to be in full force and effect;

5.4 The execution and delivery by Borrower of this Amendment and the performance by Borrower of its obligations under the Existing Loan Agreements, as amended by this Amendment, have been duly authorized;

5.5 The execution and delivery by Borrower of this Amendment and the performance by Borrower of its obligations under the Existing Loan Agreements, as amended by this Amendment, do not and will not contravene (a) any law or regulation binding on or affecting Borrower, (b) any contractual restriction with a Person binding on Borrower, (c) any order, judgment or decree of any court or other governmental or public body or authority, or subdivision thereof, binding on Borrower, or (d) the organizational documents of Borrower;

5.6 The execution and delivery by Borrower of this Amendment and the performance by Borrower of its obligations under the Existing Loan Agreements, as amended by this Amendment, do not require any order, consent, approval, license, authorization or validation of, or filing, recording or registration with, or exemption by any governmental or public body or authority, or subdivision thereof, binding on either Borrower, except as already has been obtained or made; and

5.7 This Amendment has been duly executed and delivered by Borrower and is the binding obligation of Borrower, enforceable against Borrower in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, liquidation, moratorium or other similar laws of general application and equitable principles relating to or affecting creditors' rights.

Borrower acknowledges and agrees that the representations and warranties set forth herein are material inducements to Lender to deliver this Amendment.

6. Entire Agreement. This Amendment constitutes the entire agreement and understanding between the parties hereto with respect to the subject matter of this Amendment and supersedes any and all prior agreements and understandings, written or oral, relating to the subject matter of this Amendment.

7. Headings. The headings in this Amendment are included for convenience of reference only and will be ignored in the construction or interpretation hereof.

8. Counterparts; Facsimile Signatures. This Amendment may be executed in one or more counterparts (including by facsimile signature), each of which will be deemed an original, but all of which together will constitute one and the same instrument.

9. Effectiveness. This Amendment shall be deemed effective upon the due execution and delivery to Lender of this Amendment by each party hereto.

[Signature page follows.]

IN WITNESS WHEREOF, the parties hereto have executed this Amendment as of the date first above written.

BORROWER:

DELTATHREE, INC.

By: /s/ Effi Baruch
Name: Effi Baruch
Title: CEO and President

DELTA THREE ISRAEL, LTD.

By: /s/ Effi Baruch
Name: Effi Baruch
Title: CEO and President

DME SOLUTIONS, INC.

By: /s/ Effi Baruch
Name: Effi Baruch
Title: CEO and President

LENDER:

D4 HOLDINGS, LLC

By: Praescient, LLC, its Manager

By: /s/ Robert Stevanovski
Name: Robert Stevanovski
Title: Manager

SCHEDULE A

Loan Agreement	Delinquent Interest Amount	Old Principal Balance	New Principal Balance (as of date of this Amendment)	New Principal Amount of Promissory Note
First Loan Agreement	\$164,780	\$1,200,000	\$1,364,780	\$1,364,780
Second Loan Agreement	\$137,316	\$1,000,000	\$1,137,316	\$1,137,316
Third Loan Agreement	\$219,706	\$1,600,000	\$1,819,706	\$1,819,706
Fourth Loan Agreement	\$27,463	\$200,000	\$227,463	\$227,463

**AMENDMENT TO
WARRANT AGREEMENTS**

THIS AMENDMENT TO WARRANT AGREEMENTS (this "*Amendment*") is entered into this 13th of November, 2012, by and between deltathree, Inc., a Delaware corporation (the "*Company*") and D4 Holdings, LLC, a Delaware limited liability company ("*Holder*").

RECITALS

- A. The parties hereto entered into that certain Warrant Agreement dated February 12, 2009 (the "*Original Warrant Agreement*"), pursuant to which the Company issued to the Holder a warrant to purchase an aggregate of 30,000,000 shares of the Company's Common Stock.
- B. The parties hereto also entered into that certain Warrant Agreement dated August 10, 2010 (the "*Second Warrant Agreement*"), pursuant to which the Company issued to the Holder a warrant to purchase an aggregate of 4,000,000 shares of the Company's Common Stock.
- C. The parties hereto further entered into that certain Warrant Agreement dated March 2, 2010 (the "*Third Warrant Agreement*"), pursuant to which the Company issued to the Holder a warrant to purchase an aggregate of 1,000,000 shares of the Company's Common Stock.
- D. In connection with the refinancing by the Company of outstanding indebtedness to the Holder on the date hereof, the parties hereto have agreed to amend certain provisions in the Original Warrant Agreement, the Second Warrant Agreement and the Third Warrant Agreement (together, the "*Warrant Agreements*") as set forth herein.

AGREEMENT

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

- 1. **Definitions.** Capitalized terms used but not defined herein shall have the meanings given to them in the Warrant Agreement.
- 2. **Amendment to Original Warrant Agreement.** Section 1(b) of the Warrant Agreement is hereby amended to read in its entirety as follows:
 - “(b) “Exercise Price” means \$0.02 per share (as the same may be adjusted from time to time pursuant to the terms of this Warrant).”
- 3. **Amendment to Second Warrant Agreement.** Section 1(b) of the Second Warrant Agreement is hereby amended to read in its entirety as follows:

“(b) “Exercise Price” means \$0.02 per share (as the same may be adjusted from time to time pursuant to the terms of this Warrant).”

4. **Amendment to Third Warrant Agreement.** Section 1(b) of the Third Warrant Agreement is hereby amended to read in its entirety as follows:

“(b) “Exercise Price” means \$0.02 per share (as the same may be adjusted from time to time pursuant to the terms of this Warrant).”

5. **Full Force and Effect.** Except as amended hereby, all of the terms and conditions of the Warrant Agreements will remain in full force and effect and will not be, or deemed to be, waived, modified, superseded or otherwise affected by this Amendment.

6. **Entire Agreement.** This Amendment constitutes the entire agreement and understanding between the parties hereto with respect to the subject matter of this Amendment and supersedes any and all prior agreements and understandings, written or oral, relating to the subject matter of this Amendment.

7. **Headings.** The headings in this Amendment are included for convenience of reference only and will be ignored in the construction or interpretation hereof.

8. **Counterparts; Facsimile Signatures.** This Amendment may be executed in one or more counterparts (including by facsimile signature), each of which will be deemed an original, but all of which together will constitute one and the same instrument.

[Signature page follows.]

IN WITNESS WHEREOF, the parties hereto have executed this Amendment as of the date first above written.

COMPANY:

DELTATHREE, INC.

By: /s/ Effi Baruch
Name: Effi Baruch
Title: CEO and President

HOLDER:

D4 HOLDINGS, LLC

By: Praescient, LLC, its Manager

By: /s/ Robert Stevanovski
Name: Robert Stevanovski
Title: Manager

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAWS. THESE SECURITIES MAY NOT BE OFFERED FOR SALE, SOLD OR OTHERWISE DISPOSED OF EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT FILED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER SUCH ACT. ANY SUCH DISPOSITION MAY ALSO BE SUBJECT TO APPLICABLE STATE SECURITIES LAWS.

VOID AFTER 5:00 P.M., NEW YORK, NEW YORK TIME, ON THE EXPIRATION DATE (AS DEFINED BELOW).

Date of Issuance: November 13, 2012

Number of Shares: **10,000,000**

WARRANT TO PURCHASE
SHARES OF COMMON STOCK OF
DELTATHREE, INC.

This certifies that, for value received, D4 Holdings, LLC, a Delaware limited liability company, and its permitted assigns or successors in interest (the "Holder"), is entitled to purchase from deltathree, Inc., a Delaware corporation (the "Company"), subject to the terms and conditions hereof, at any time on or after the date of this Warrant and before 5:00 P.M., New York, New York time on the date which is ten (10) years after the date hereof (the "Expiration Date"), that number of fully paid and non-assessable shares of the Company's common stock, par value \$0.001 (the "Common Stock"), as set forth in Section 2 hereof.

1. **Definitions**. As used in this Warrant, the following terms shall have the meanings set forth below:

(a) "Exercise Period" means the period beginning on the date of this Warrant and ending on the Expiration Date.

(b) "Exercise Price" means \$0.02 per share (as the same may be adjusted from time to time pursuant to the terms of this Warrant).

(c) "Fair Market Value" means, on any particular date (a) if the Common Stock is then traded on a securities exchange, the average of the closing prices of such Common Stock on such exchange over the five trading day period ending on such date, (b) if the Common Stock is then regularly traded over-the-counter, the average of the closing sale prices or secondarily the closing bid of such Common Stock over the five trading day period ending on such date, or (c) if there is no active public trading market for the Common Stock, the fair market value of one share of the Warrant Shares as determined in good faith by the Board of Directors of the Company.

(d) “Person” (whether or not capitalized) means an individual, entity, partnership, limited liability company, corporation, association, trust, joint venture, unincorporated organization or any other form of entity not specifically listed herein, and any government, governmental department or agency or political subdivision thereof.

(e) “Securities Act” means the Securities Act of 1933, as amended, and all of the rules and regulations promulgated thereunder.

(f) “Warrant” means this Warrant and all stock purchase warrants issued in exchange therefor pursuant to the terms thereof.

(g) “Warrant Shares” means the shares of Common Stock issuable upon exercise of this Warrant.

2. Exercise of Warrant.

(a) Number of Shares Underlying Warrant. This Warrant shall be exercisable for up to **10,000,000** shares of Common Stock, as adjusted from time to time pursuant to the terms of this Warrant.

(b) Exercisability of Warrant. This Warrant may be exercised by Holder, in whole or in part, in accordance with its terms, at any time or from time to time beginning on the date hereof and ending at 5:00 p.m., New York City time, on the Expiration Date.

(c) Exercise Procedure.

(i) The purchase rights represented by this Warrant may be exercised by the Holder, in whole or in part, by delivery of a notice of exercise in the form set forth on the last page hereof (the “Exercise Notice”) at the principal office of the Company, and by the payment to the Company of the aggregate Exercise Price (in accordance with the next sentence) in an amount equal to the Exercise Price per share multiplied by the number of Warrant Shares then being purchased. The aggregate purchase price for Warrant Shares being purchased hereunder pursuant to such exercise may be paid either (A) by cash or wire transfer of immediately available funds, (B) by cancellation of indebtedness, (C) by surrender of a number of Warrant Shares which have a Fair Market Value equal to the aggregate purchase price of the Warrant Shares being purchased (“Net Issuance”) as determined herein, or (D) any combination of the foregoing. If the Holder elects the Net Issuance method of payment, the Company shall issue to Holder upon exercise a number of shares of Warrant Shares determined in accordance with the following formula:

$$X = \frac{Y(A-B)}{A}$$

where: X = the number of Warrant Shares to be issued to the Holder;

- Y = the number of Warrant Shares with respect to which the Holder is exercising its purchase rights under this Warrant;
- A = the Fair Market Value of one (1) share of the Warrant Shares on the date immediately preceding the date of exercise; and
- B = the Exercise Price.

(ii) No fractional shares arising out of the above formula for determining the number of shares to be issued to the Holder shall be issued, and the Company shall, in lieu thereof, make payment to the Holder of cash in the amount of such fraction multiplied by the Fair Market Value of one (1) share of the Warrant Shares on the date of exercise.

(iii) In the event of any exercise of the rights represented by this Warrant, certificates for the Warrant Shares so purchased shall be delivered to the Holder as soon as practicable and, unless this Warrant has been fully exercised or has expired, a new Warrant representing the portion of the Warrant Shares, if any, with respect to which this Warrant shall not then have been exercised shall also be issued to the Holder as soon as practicable. Such exercise shall be deemed to have been made immediately prior to the close of business on the date the Holder delivers the Exercise Notice with respect to such exercise.

3. Reservation of Warrant Shares; Stock Fully Paid. During the Exercise Period, the Company shall reserve and keep available for issuance upon the exercise of the Warrant such number of its authorized but unissued shares of Common Stock as will be sufficient to permit the exercise in full of all outstanding Warrants. The Warrant Shares, upon issuance in accordance with the terms of this Warrant, will be validly issued, fully paid and nonassessable, and free from all taxes, liens and charges with respect to the issuance thereof.

4. No Voting Rights; Limitations of Liability. This Warrant will not entitle the Holder to any voting rights or other rights as a shareholder of the Company. No provision of this Warrant, in the absence of affirmative action by the Holder to purchase Warrant Shares, and no enumeration in this Warrant of the rights or privileges of the Holder, will give rise to any liability of such Holder as a stockholder of the Company.

5. Representations of Holder; Restrictions on Transfer.

(a) The Holder certifies and represents to the Company that it is an "accredited investor" as defined in Rule 501 of Regulation D promulgated under the Securities Act. The Holder's financial condition is such that it is able to bear the risk of holding the Securities for an indefinite period of time and the risk of loss of its entire investment. The Holder has sufficient knowledge and experience in investing in companies similar to the Company so as to be able to evaluate the risks and merits of its investment in the Company. The Holder is acquiring the Securities for its own account for investment and not for resale or with a view to distribution thereof in violation of the Securities Act. The Holder understands that the Securities have not been registered under the Securities Act, by reason of their issuance by the Company in a transaction exempt from the registration requirements of the Securities Act, and that the Securities must continue to be held by the Holder unless a subsequent disposition thereof is registered under the Securities Act or is exempt from such registration.

(b) The Holder agrees that the Holder will not transfer, sell or otherwise dispose of this Warrant without the express consent of the Company in its reasonable discretion. Notwithstanding the foregoing, the Holder may transfer all or any portion of this Warrant to an affiliate (as such term is defined in Rule 405 promulgated under the Securities Act) of the Holder.

(c) The Holder agrees not to sell, pledge, distribute, offer for sale, transfer or otherwise dispose of this Warrant or any Warrant Shares issued upon its exercise except under circumstances which will not result in a violation of the Securities Act. Upon exercise of this Warrant, the Holder shall confirm in writing, by executing the form attached hereto, that the securities purchased thereby are being acquired for investment solely for the Holder's own account and not as a nominee for any other person, and not with a view toward distribution or resale.

(d) The certificates representing the Warrant Shares shall have affixed thereto a legend in substantially the following form, in addition to other legends required by applicable state law:

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR ANY STATE SECURITIES LAW, AND MAY NOT BE TRANSFERRED, SOLD OR OTHERWISE DISPOSED OF UNLESS THE SAME ARE REGISTERED AND QUALIFIED IN ACCORDANCE WITH THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS, OR IN THE OPINION OF COUNSEL REASONABLY SATISFACTORY TO THE ISSUER SUCH REGISTRATION IS NOT REQUIRED UNDER THE ACT.

(e) With respect to any offer, sale or other disposition of this Warrant or any Warrant Shares, the Holder agrees to give written notice to the Company prior thereto, describing briefly the manner thereof together with a written opinion of the Holder's counsel, if reasonably requested by the Company, to the effect that such offer, sale or other disposition of this Warrant or such Warrant Shares may be effected without registration under the Securities Act or qualification under any applicable state securities laws, and indicating whether or not under the Securities Act certificates for this Warrant or such Warrant Shares, as the case may be, to be sold or otherwise disposed of require any restrictive legend as to applicable restrictions on transferability in order to insure compliance with the Securities Act. If the Company shall consent to the transfer of this Warrant or such Warrant Shares, then each certificate representing this Warrant or the Warrant Shares thus transferred (except a transfer pursuant to Rule 144) shall bear a legend as to the applicable restrictions on transferability in order to insure compliance with the Securities Act, unless in the aforesaid reasonably satisfactory opinion of counsel for the Holder or the security holder, as the case may be, such legend is not necessary in order to insure compliance with the Securities Act. The Company may issue stop transfer instructions to its transfer agent in connection with such restrictions.

6. Miscellaneous.

(a) Amendment and Waiver. Except as otherwise provided herein, the provisions of this Warrant may be amended only if the Company has obtained the prior written consent of the Holder.

(b) Notices. Any notices required to be sent to the Holder will be delivered to the address set forth below. Any notices required to be sent to the Company will be delivered to the principal office of the Company as set forth on the signature page hereto. Any party may change the address to which correspondence to it is to be addressed by written notification as provided herein. All notices required or permitted hereunder, to be effective, shall be in writing and shall be deemed effectively given: (i) when sent by confirmed facsimile if sent during normal business hours of the recipient, if not, then on the next business day, (ii) five (5) days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (iii) one (1) business day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt.

If to the Holder, to:

D4 Holdings, LLC
349-L Copperfield Blvd, #407
Concord, NC 28025
Attention: Robert Stevanovski, Manager
Facsimile: 704.260.3304

With a copy to (which shall not constitute notice):

D4 Holdings, LLC
349-L Copperfield Blvd, #407
Concord, NC 28025
Attention: General Counsel
Facsimile: 704.260.3304

(c) Descriptive Headings: Pronouns. The descriptive headings of the paragraphs of this Warrant are inserted for convenience only and do not constitute a part of this Warrant. All pronouns or any variation thereof shall be deemed to refer to the masculine, feminine or neuter, singular or plural, as the identity of the person, persons, entity or entities may require.

(d) Governing Law. This Warrant shall be governed by and construed in accordance with the internal and substantive laws of the State of Delaware and without regard to any conflicts of laws concepts which would apply the substantive law of some other jurisdiction.

(e) Successors and Assigns. Subject to Section 5, the provisions of this Warrant shall be binding upon, and inure to the benefit of, the respective successors and assigns of the parties hereto.

(f) Severability. In the event that any one or more of the provisions of this Warrant shall for any reason be held to be invalid, illegal or unenforceable, in whole or in part or in any respect, or in the event that any one or more of the provisions of this Warrant operate or would prospectively operate to invalidate this Warrant, then and in any such event, such provision(s) only shall be deemed null and void and shall not affect any other provision of this Warrant and the remaining provisions of this Warrant shall remain operative and in full force and effect and in no way shall be affected, prejudiced, or disturbed thereby.

(g) Waiver of Jury Trial. EACH OF THE COMPANY AND THE HOLDER WAIVES ALL RIGHTS TO TRIAL BY JURY OF ANY SUITS, CLAIMS, COUNTERCLAIMS, AND ACTIONS OF ANY KIND ARISING UNDER OR RELATING TO THIS AGREEMENT. EACH OF THE COMPANY AND THE HOLDER ACKNOWLEDGES THAT THIS IS A WAIVER OF A LEGAL RIGHT AND REPRESENTS TO THE OTHER THAT THIS WAIVER IS MADE KNOWINGLY AND VOLUNTARILY. THE COMPANY AND THE HOLDER EACH AGREE THAT ALL SUCH SUITS, CLAIMS, COUNTERCLAIMS, AND ACTIONS SHALL BE TRIED BEFORE A JUDGE OF A COURT OF COMPETENT JURISDICTION, WITHOUT A JURY.

(h) Adjustments.

(i) If at any time after the date hereof there is any change in the outstanding shares of capital stock of the Company by reason of stock dividends, splits, recapitalizations, reclassifications, combinations or exchanges of shares, separations, reorganizations, liquidations, or the like, the number and class of shares available under this Warrant in the aggregate and the Exercise Price, as applicable, shall be correspondingly adjusted to give the Holder, on exercise for the same aggregate Exercise Price, the total number, class, and kind of shares as the Holder would have owned had the Warrant been exercised prior to the event and had the Holder continued to hold such shares until after the event requiring adjustment. The form of this Warrant need not be changed because of any adjustment in the number of Warrant Shares subject to this Warrant.

(ii) In case of any reclassification or change of outstanding securities of the class and series issuable upon exercise of this Warrant (other than a change in par value, or from par value to no par value, or from no par value to par value, or as a result of a subdivision or combination), or in case of any consolidation or merger of the Company with or into a continuing corporation (other than a merger with another corporation in which the Company is a continuing corporation and which does not result in any reclassification or change of outstanding securities issuable upon exercise of this Warrant), or in case of a sale of all or substantially all of the assets of the Company, unless this Warrant shall have been exercised or terminated in accordance with its terms, the Company, or such successor or purchasing corporation, shall execute a new Warrant, which provides that the Holder shall have the right to exercise such new Warrant and procure upon such exercise in lieu of each Warrant Share theretofore issuable upon exercise of this Warrant the kind and amount of shares of stock, other securities, money and property receivable upon such reclassification, change, merger or transfer by a holder of one share of the type of security issuable upon exercise of this Warrant. Such new Warrant shall provide for adjustments which shall be as nearly equivalent as may be practicable to the adjustments provided for in this Section 6(h). The provisions of this Section 6(h)(ii) shall similarly apply to successive reclassifications, changes, mergers or transfers.

(iii) If at any time after the date hereof any change occurs in the outstanding capital stock of the Company or any other event occurs as to which the other provisions of this Section 6(h) are not strictly applicable or if strictly applicable would not fairly protect the purchase rights of the Holder in accordance with such provisions, then the independent members of the Board of Directors of the Company shall, in their reasonable good faith judgment, make an adjustment in the number and class of shares available under the Warrant, the Exercise Price or the application of such provisions, as applicable, so as to protect such purchase rights as aforesaid. The adjustment shall be such as to give the Holder upon exercise for the same aggregate Exercise Price the total number, class and kind of shares as the Holder would have owned had this Warrant been exercised prior to the event and had the Holder continued to hold such shares until after the event requiring adjustment.

(iv) Whenever the Exercise Price shall be adjusted pursuant to this Section 6(h), the Company shall issue a certificate signed by its chief financial officer or other executive officer setting forth, in reasonable detail, the event requiring the adjustment, the amount of the adjustment, the method by which such adjustment was calculated, and the Exercise Price (and, if applicable, the number and type of security for which the Warrant may be exercised) after giving effect to such adjustment, and shall cause copies of such certificate to be mailed (by first class mail, postage prepaid) to the Holder.

[Signature page follows]

IN WITNESS WHEREOF, each of the parties has caused this Warrant to be executed by its duly authorized officer as of the date first written above.

COMPANY:

DELTATHREE, INC.

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

Address:

Jerusalem Technology Park – Bldg. #9
P.O. Box 48265
Jerusalem 91481, Israel
Attention: Chief Executive Officer
Facsimile: 011.972.2.649.1200

HOLDER:

D4 HOLDINGS, LLC

By: Praescient, LLC, its Manager

By: /s/ Robert Stevanovski
Name: Robert Stevanovski
Title: Manager

NOTICE OF EXERCISE

TO: DELTATHREE, INC.

1. The undersigned hereby elects to purchase _____ shares of common stock, par value \$0.001 (the "Common Stock"), of deltathree, Inc. (the "Company") pursuant to the terms of that certain Warrant issued by the Company to D4 Holdings, LLC as of October __, 2012, and tenders herewith payment of the purchase price of such shares in full, together with all applicable transfer taxes, if any, in accordance with the election set forth in paragraph 2 below.

2. Manner of Exercise. The undersigned Holder elects to exercise the Warrant for such shares of Common Stock in the following manner:

- Cash Exercise. The undersigned tenders herewith payment of the aggregate Exercise Price for the Common Stock in the form of cash or wire transfer of immediately available funds.
- Cancellation of Indebtedness. The undersigned tenders payment of the aggregate Exercise Price for the Common Stock by cancelling \$_____ of outstanding indebtedness owed by the Company to Holder, which cancellation shall be deemed effective simultaneously with the delivery of this Notice;
- Cashless or "Net Issuance" Exercise. The undersigned hereby elects to exercise this Warrant by means of a Net Issuance exercise pursuant to the provision of Section 2(c)(i) of the Warrant.

3. Please issue a certificate or certificates representing said securities in the name of the undersigned or in such other name as is specified below:

(Name)

(Address)

4. The undersigned represents that the aforesaid shares of Common Stock are being acquired for the account of the undersigned for investment and not with a view to, or for resale in connection with, the distribution thereof, and that the undersigned has no present intention of distributing or reselling such shares in violation of applicable securities laws.

(Signature)

(Date)

Exhibit 31.1

CERTIFICATION BY PRINCIPAL EXECUTIVE OFFICER

I, Effi Baruch, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of deltathree, Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 14, 2012

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

Exhibit 31.2

CERTIFICATION BY PRINCIPAL FINANCIAL OFFICER

I, Yochai Ozeri, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of deltatthree, Inc. (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2012

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

Exhibit 32.1

CERTIFICATION

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

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

- (1) the Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (the "Form 10-Q") of the registrant fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the registrant.

Date: November 14, 2012

By: /s/ Effi Baruch

Effi Baruch, Chief Executive Officer, President, Senior Vice
President of Operations and Technology and Secretary

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

Exhibit 32.2

CERTIFICATION

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

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

- (1) the Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (the "Form 10-Q") of the registrant fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the registrant.

Date: November 14, 2012

By: /s/ Yochai Ozeri

Yochai Ozeri, Director of Finance and Treasurer

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