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Annual Report 2002

Dear Stockholders, Customers, Partners and Employees,

Having joined deltathree in 1997 and seen the Company grow from a startup to a leader in the development of VoIP consumer services, it was an honor to be appointed to the role of Chief Executive Officer in June of 2002. In taking on the role of CEO it was clear that deltathree's primary mission must focus on creating an effective balance of product innovation and improved profitability, while continuing to deliver the highest quality IP telephony services to our customers worldwide.

While deltathree's mission was clear, it was also clear that the path ahead would be a challenging one. With declining equity market valuations, weakening global economic conditions and a broad crisis in investor confidence providing the financial backdrop in 2002, the economic environment was a difficult one. These broad factors ran parallel to an ongoing consolidation trend and increased pricing pressure within the telecommunications sector. The result was a decline in telecommunications spending and an industry wide slowdown in the roll-out of next generation VoIP offerings, which negatively impacted the revenue growth of deltathree throughout 2002.

Despite these formidable market forces, I am pleased to report that deltathree made significant progress on its core financial objectives by focusing on higher value, higher margin offerings and reducing its quarterly net loss. deltathree's success in meeting these objectives was evident as gross margins reached record highs and deltathree's quarterly net loss reached record lows. Our progress was driven by a strong focus on our higher margin iConnectHere offering, which contributed to deltathree achieving gross margins of 31% for fiscal year 2002 compared to 14% in fiscal year 2001. deltathree's success in improving this important financial measure throughout 2002 was clear as gross margins reached a record high of 38% in the fourth quarter of 2002.

Building on our gains in improving margins, deltathree made important progress in driving towards our stated goals of financial discipline and long-term profitability. During 2002, deltathree achieved its ninth consecutive quarter of sequential improvement in reducing the Company's quarterly net loss as well as meeting our stated earnings guidance. As of year end 2002, deltathree reduced its quarterly net loss to \$2.5 million or \$0.09 per share, a 75% improvement over the same period in 2001. Supporting our progress in increasing margins and reducing our quarterly net loss has been a strict focus on improving financial efficiency and reducing operating expenses. With ample capital on hand to fund our business model, no debt, a quarterly cash burn rate of less than \$1 million a quarter and a clean balance sheet, deltathree has the financial strength to achieve its goal of profitability.

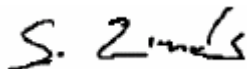
Looking ahead, a variety of positive factors are converging in the communications marketplace to create new momentum in the VoIP industry. These factors are helping pave the way for increased VoIP customer penetration rates, including:

- *Dramatic increases in the quality of VoIP phone calls,*
- *The convergence of packetized voice, data and advanced telephony services,*
- *Rising broadband penetration rates around the world,*
- *Rising demand for communications services that meet the mobile and flexible consumer lifestyles of today,*
- *The opening of additional foreign markets to VoIP services,*
- *And a communications market that is increasingly embracing the high value, low cost economics of Internet telephony.*

Based upon these fundamental growth drivers, deltathree is reaching new customers around the world with value-oriented VoIP based products and services.

On behalf of the management team of deltathree, I would like to thank all our customers, employees, strategic partners and stockholders for their contributions and support throughout 2002.

Sincerely,



Shimmy Zimels

President and Chief Executive Officer

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A
(Amendment No. 1 to Form 10-K)

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

For the Fiscal Year Ended December 31, 2002

Commission File Number: 000-28063

DEL TATHREE, INC.

(Exact name of registrant as specified in charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

75 Broad Street, 31st Floor

New York, New York 10004

(Address of principal executive offices)

13-4006766

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

10004

(Zip code)

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

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

None.

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

Title of Each Class

Class A Common Stock, par value \$0.001 per share

Name of Each Exchange on Which the
Securities are Registered

Nasdaq SmallCap Market

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

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

The aggregate market value of the Class A common stock held by non-affiliates of the Registrant based upon the closing price of the Class A common stock as reported by The Nasdaq Stock Market on June 28, 2002 was \$5,692,191. Solely for purposes of this calculation, shares beneficially owned by directors and officers of the Registrant and persons owning 5% or more of the Registrant's Class A common stock have been excluded, in that such persons may be deemed to be affiliates of the Registrant. Such exclusion should not be deemed a determination or admission by the Registrant that such individuals or entities are, in fact, affiliates of the Registrant.

The number of shares outstanding of the Registrant's capital stock as of April 21, 2003 is as follows:

Title of Each Class

Class A Common Stock, \$0.001 par value

Number of Shares Outstanding
at April 21, 2003

29,180,896

EXPLANATORY NOTE

This document is a compilation of the Company's Form 10-K originally filed on April 1, 2003 and Form 10-K/A (the "Amendment") filed on April 30, 2003. This document incorporates Part I and Part II from the Company's Form 10-K originally filed on April 1, 2003 and Part III and Part IV from the Amendment. Information required by Part III of Form 10-K, incorporated in the Amendment, filed on April 30, 2003, was omitted from the Company's Form 10-K as originally filed on April 1, 2003.

DELTATHREE, INC.
2002 ANNUAL REPORT ON FORM 10-K

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DELTATHREE, INC.
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The statements in this annual report that are not descriptions of historical facts may be forward-looking statements. Those statements involve substantial risks and uncertainties. You can identify those statements by the fact that they contain words such as "anticipate," "believe," "estimate," "expect," "intend," "project" or other terms of similar meaning. Those statements reflect management's current beliefs, but are based on numerous assumptions, which we cannot control and that may not develop as we expect. Consequently, actual results may differ materially from those projected in the forward-looking statements. Among the factors that could cause actual results to differ materially are: uncertainty of financial estimates and projections, the competitive environment for Internet telephony, our limited operating history, changes of rates of all related telecommunications services, the level and rate of customer acceptance of new products and services, legislation that may affect the Internet telephony industry, rapid technological changes, and the risks, uncertainties and other matters discussed below under "Risk Factors" and elsewhere in this annual report and in our other periodic reports filed with the U.S. Securities and Exchange Commission.

PART I

ITEM 1. BUSINESS

General

We are a provider of integrated Voice over Internet Protocol (VoIP) telephony services. We were founded in 1996 to capitalize on the growth of the Internet as a communications tool by commercially offering Internet Protocol (IP) telephony services. IP telephony is the real time transmission of voice communications in the form of digitized "packets" of information over the Internet or a private network, similar to the way in which e-mail and other data is transmitted. Our business currently includes: the provision of enhanced Web-based and other communications services to individual consumers, under our iConnectHere brand name; the provision of enhanced Web-based and other communications services to international resellers, under either their own brand name, a white-label brand, and/or our iConnectHere brand name; the provision of a total "Hosted Communications Solution" that enables corporate customers and service providers to offer private label telecommunications to their customer bases, and; the transmission of voice and data traffic for communications carriers.

We have built a privately-managed, global network using IP technology and offer our customers a unique suite of IP telephony products, including: PC-to-Phone, Phone-to-Phone, and Broadband Phone. We differentiate ourselves from our competitors by providing a robust set of value-added services that enables us to effectively address the challenges that have traditionally made the provision of telecommunications services difficult. These operations management tools include: account provisioning; payment processing systems; billing and account management; and customer care. We are able to provide our services at a cost to users that is generally lower than that charged by traditional carriers because we minimize our network costs by using efficient packet-switched technology and we generally avoid local access charges and by-pass international settlement charges by routing international long distance calls over our privately-managed network.

Prior to 1999, our focus was to build 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 Web site. 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. Our privately-managed IP network received the Best Built Public Network Award for excellence in IP services/applications at SUPERCOMM 2000. We were also recognized as the best IP telephony provider by SmartMoney magazine and PC World Magazine during 2000. We were recognized for our innovative Broadband Phone offering during 2001, receiving both the TMC Labs Innovation Award,

and the Communications SOLUTIONS[®] magazine Product of the Year Award. In 2001, we continued to enhance our unique strengths through our pioneering work with the Session Initiation Protocol (SIP), an Internet Engineering Task Force standard that has been embraced by industry leaders such as Microsoft and the 3rd Generation Partnership Project (3GPP), which is a global cooperation between six organizational partners who are recognized as the world's major standardization bodies from the United States, Europe, China, Japan and Korea. In 2001, we also announced the launch of our state-of-the-art SIP (Session Initiation Protocol) infrastructure, and we became one of the first service providers to have built an end-to-end SIP network. During 2002, our continuing SIP efforts resulted in our launch of our SIP-based dialer. These efforts continue to position us as one of the leading providers of VoIP services.

Recent Developments

On February 6, 2003, we announced that we had received a letter from D3 Acquisition, Inc. relating to a proposal to purchase all of our outstanding shares not held by Atarey Hasharon Chevra Lepituach Vehashkaot Benadlan (1991) Ltd. (“Atarey”) and its affiliates for a price of \$0.70 per share in cash by means of a cash tender offer. The proposal contemplates that upon successful completion of the tender offer, D3 Acquisition would merge into us and we would survive and continue as a wholly owned private subsidiary of Atarey. D3 Acquisition is a wholly owned special purpose acquisition corporation formed by Atarey. Together, Atarey and its affiliates currently own approximately 71% (20,655,402 shares) of our outstanding common stock. Our board of directors has formed a special committee comprised of independent directors to evaluate the proposal and negotiate its terms. The special committee of our board of directors has retained Kaufman Bros., L.P. as its financial advisor to assist the special committee in evaluating strategic alternatives, including a possible sale of the company. Among other things, Kaufman Bros. is assisting the special committee in its continuing assessment of the D3 Acquisition proposal. Upon completion of this review process, the special committee of independent directors will make its recommendation to our board of directors in due course. There can be no assurance that Atarey or we will proceed with the proposed transaction or any of the other strategic alternatives considered or when any resulting transaction would occur. Upon our announcement that we were evaluating the D3 Acquisition offer, litigation was commenced against our Board members and us with respect to the transaction contemplated by the proposal. Please see “Legal Proceedings” for a description of such litigation.

The Increasing Significance of IP Communications

Historically, the communications services industry has transmitted voice and data over separate networks using different technologies. Traditional carriers have typically built telephone networks based on circuit switching technology, which establishes and maintains a dedicated path for each telephone call until the call is terminated. Although a circuit-switched system reliably transmits voice communications, circuit switching does not efficiently utilize transmission capacity. When a telephone call is placed, a circuit is established, and the circuit remains dedicated for transmission of the call and is therefore unavailable to transmit any other call.

Data networks have typically been built utilizing packet switching technology, such as IP, which divides signals into packets that are simultaneously routed over different channels to a final destination where they are reassembled in the original order in which they were transmitted. Packet switching provides for more efficient use of the capacity in the network because the network does not establish dedicated circuits and does not require a fixed amount of bandwidth to be reserved for each transmission. As a result, substantially greater traffic can be transmitted over a packet-switched network, such as the Internet, than a circuit-switched network.

Traditional telecommunications carriers have historically avoided the use of packet switching for transmitting voice calls due to poor sound quality attributable to delays and lost packets which prevent real-time transmission. However, recent improvements in packet switching, compression and broadband access technologies, improved hardware and the use of privately-managed networks (such as our network) have significantly improved the quality of packet-switched voice calls, allowing for real-time transmission. Service providers that use privately-managed networks are able to reduce packet loss and latency, or delay, because they are able to control the amount, timing and route of data transmitted.

As a result, packet switching technology enables service providers to converge their traditional voice and data networks and more efficiently utilize their networks by carrying voice, fax and data traffic over the same network. The improved efficiency of packet-switching technology creates network cost savings that can be passed on to the consumer in the form of lower long distance rates. In addition, international telephone calls carried over the Internet or private IP networks are less expensive than similar calls carried over circuit-switched networks primarily because they bypass the international settlement process, which represents a significant portion of international long distance tariffs.

Frost & Sullivan, a market research firm, estimates that VoIP communications services will grow to represent approximately 75% of worldwide voice services and revenues from the VoIP marketplace will surpass \$171 billion by the end of 2007. Beyond cost savings, we believe that advanced IP communications technologies will further the potential for the Internet to become the preferred medium of communications and commerce.

Limitations of Existing IP Communications Solutions

Although the growth of IP telephony historically has been limited by poor sound quality attributable to delays and packet loss, recent technological advancements have significantly improved the quality of packet-switched telephone calls. As a result, several large long distance carriers, including AT&T and Sprint, have announced IP telephony service offerings.

In addition, many smaller service providers have begun to offer low-cost Internet telephony services from PCs to telephones and from telephones to telephones. Many of these service providers, however, offer their services only in certain geographic areas and provide limited services. In addition, many of these service providers rely solely on the public Internet for transmission, rather than a privately-managed IP network. In using only the public Internet rather than a privately-managed IP network for transmission, these service providers have less control over the network management and monitoring functions that are necessary to ensure quality of service.

Our Products and Services

Products.

We have built a privately-managed, global network using IP technology and offer our customers a unique suite of IP telephony products. Our enhanced IP communication products (which represented 60.2% and 54.8% of our revenues in 2002 and 2001, respectively) include:

PC-to-Phone. Our PC-to-Phone offering enables a user to conveniently and inexpensively place a call to a standard telephone anywhere in the world directly from a personal computer while remaining on-line. In order to use this product, a user need only download our software from our Web site and have access to the Internet. Once our software is downloaded, the user is able to place a call from the user's personal computer and, while browsing the Web, speak to a party who uses a standard telephone. Alternatively, users of Microsoft's MSN Messenger software can access our PC-to-Phone product through the "Make a phone call" function without the need to download any other software.

We are able to provide our PC-to-Phone offering at rates generally lower than those charged for traditional circuit switched calls. We are able to charge lower rates because our service utilizes packet-switched technology and because it routes calls directly from the user's Internet connection onto our privately-managed IP network and to the called destination, thus avoiding access and settlement rates associated with traditional international and domestic long distance telecommunications services. PC-to-phone is currently our most popular product offering.

Phone-to-Phone. Our Phone-to-Phone offering enables a user to inexpensively place a call or send a fax from a standard telephone or a fax machine to anywhere in the world. Phone-to-Phone calls originate and terminate on the public switched telephone network (PSTN), but travel primarily over our privately-managed IP network. Similar to our PC-to-Phone product, our Phone-to-Phone product is generally less expensive than services of traditional carriers. Users can access our Phone-to-Phone product by dialing a local or toll-free access number and providing a PIN number. We

currently offer toll-free access numbers in Austria, Canada, Finland, France, Germany, Hong Kong, Italy, Sweden, Switzerland, the United Kingdom and the United States. Users are charged for toll and long distance calls on a per-minute basis. We and our private-label partners receive payment for these calls by debiting pre-paid user accounts opened on-line and through the sale of pre-paid calling cards.

Broadband Phone. In early 2001, we successfully deployed the world's first commercially available Broadband Phone offering. Our Broadband Phone product is a complete phone replacement solution available to business and consumer customers over the "last mile" through broadband connections via cable modem, DSL or fixed wireless. Broadband Phone challenges the traditional PSTN and circuit switched networks with a full VoIP solution. With our high call quality, "always on" reliability and increased functionality provided by the high bandwidth access line, we are able to offer potential partners and their customers some of the most sophisticated VoIP solutions available in the market through a highly scalable, low-cost and easily implemented product. Broadband Phone is designed to take advantage of how people communicate, building on the current customer experience by allowing them to use their existing phone. In addition to offering traditional telecommunications capabilities, Broadband Phone enables a user to conveniently retrieve e-mail, voice mail and faxes, as well as send e-mail, from a single source. For our potential partners, the turnkey solution is delivered with our full back-end infrastructure, including customer service for end users, customer service for service providers, pricing information, billing and provisioning and fraud services. Additionally, Broadband Phone is a technology-neutral solution, easily integrated (a variety of devices are available to plug directly into a PC or IP network) so as to allow broadband providers to begin delivering our voice solution rapidly.

Carrier transmission services. In addition to our enhanced IP communication products, in order to maximize the use of our available network capacity, we offer carrier transmission services over our privately-managed IP network to telecommunications carriers.

Services.

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

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

iConnectHere

We began marketing our on-line consumer offering under the iConnectHere brand name in September 2000 in connection with the formal roll-out of our Hosted Communications Solution. At that time, we decided to eliminate our free on-line service and to move away from a business model focused on consumers with a high acquisition cost. We have positioned iConnectHere as a powerful showcase and test facility for our current and future products and services. iConnectHere demonstrates our products, services and hosting capabilities to other business customers and service providers. Through iConnectHere, an account holder can access PC-to-Phone, Phone-to-Phone, Broadband Phone and the full range of our back-end infrastructure and support. Additionally, iConnectHere permits us to collect usage

information on our products and services and enables us to provide our partners with key information and recommendations regarding implementation of our products and services.

Through iConnectHere, consumer users can:

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

iConnectHere Marketing, Advertising and Promotional Programs

We have developed and will continue to develop diversified marketing, advertising and promotional programs to stimulate demand for our iConnectHere services. Our marketing, advertising and promotional programs include:

On-line agent commission program. We have developed a Web-based agent program that allows for rapid agent enrollment and agent account maintenance. Agents may devise their own marketing programs, including Web-links, direct mail campaigns or co-branding of our services in select markets. Agents receive as commissions a percentage of revenue generated from end users who sign up for our services through the agent's Web site. We believe that providing our agents with easy, on-line access to these marketing tools helps us to maximize the number of agents selling our services while significantly reducing the resources needed to recruit agents.

Off-line agent commission program. Our off-line agent commission program allows non-Web agents to design their own marketing programs to solicit sales of our services. Off-line agents market and advertise through traditional channels such as newspaper and magazine advertisements, direct mail campaigns and telemarketing campaigns. Off-line agents receive a percentage of revenue generated from users who sign up for our services through the agent's programs. We currently have relationships with more than 30 off-line agents that have generated revenue for us.

Reseller program. We offer individuals and businesses the opportunity to become resellers of our services through our reseller program. Resellers are able to purchase bulk iConnectHere account numbers at reseller specific rates that they are then able to resell to private individuals as either Phone-to-Phone calling cards or PC-to-Phone accounts.

Microsoft Messenger Affiliation. Through our relationship with Microsoft, we provide PC-to-Phone service for Microsoft MSN Messenger users, to any phone number in the world. Within the Microsoft MSN Messenger program, choosing us is similar to choosing a long distance provider. With a click of the mouse, consumers can select us (under our iConnectHere brand) when utilizing the voice function bundled into the Microsoft software applications. When consumers choose us, we provide the network call delivery and termination as well as all the billing and customer relationship aspects of the service. By way of this relationship, we gain exposure to millions of current Microsoft MSN Messenger users.

Our Hosted Communications Solution

Our "Hosted Communications Solution" leverages our VoIP expertise and delivers to our corporate customers and service providers a highly customizable, private-label suite of VoIP products and services. Using our award-winning infrastructure, we enable these enterprises to offer their customers any combination of our basic products and services, accessible through a single account. We believe that our Hosted Communications Solution brings our customers the value-added services they need to leverage their strong customer bases and generate new revenues. We have dedicated significant resources to this area of our business and anticipate significant growth in the number of businesses to which we provide our Hosted Communications Solution.

With each new module that is added to our suite of VoIP products and services, customers can realize new revenue streams from their existing customer base and make their own offering even more powerful in attracting new customers. The products and services delivered under our Hosted Communications Solution are operative 24 hours a day, 7 days a week and are supported at all times by our Network Operations Center ("NOC") and our customer care center.

Future Products—Broadband focus

The market for broadband access services is projected to grow significantly over the next several years. Broadband access alone, however, is not a complete solution. As infrastructure pipes become commodities, maintaining margin and profitability on them is becoming increasingly difficult for service providers. We believe that broadband market success will be determined by the ability to layer high-margin enhanced services and applications over the infrastructure. Market leaders will need innovative, value-added solutions to maintain customers, reduce churn and grow their customer base.

We have been developing a suite of next-generation Broadband Phone products that we believe will encompass a rich sub-set of the voice-related services broadband providers will seek to deploy in the near-term. These products will build on our original Broadband Phone offering, and include a more diverse set of devices (both hardware devices as well as "soft-phones") along with additional value-added functionality and features that will appeal to a wide potential customer-base.

Our Network

In order to deliver unique VoIP services, we operate a privately-managed IP telephony network. By managing our network, we have the ability to regulate traffic volumes and to directly control the quality of service from each originating point of presence ("POP") to the termination point via a variety of termination options. In addition, our network allows us to avoid the significant transmission delays associated with the Internet, which may impede delivery of high quality, reliable services to our users. Since the protocols used by the network are highly standard protocols, our IP network has a tight connection to the public Internet, allowing us to use the Internet as a backup facility. This unique situation, where our IP network is considered a high-quality extension of the Internet, allows our customers to enjoy best-of-breed functionality: high quality, low jitter and low connection delay, on the one hand, and global reach and universal access, on the other hand.

During 2001, in conjunction with our relationship with Microsoft and over 12 months of work, we rolled out our state of the art SIP (Session Initiation Protocol) infrastructure. Our SIP network currently powers the majority of our offerings, including our Microsoft relationship. The SIP protocol is one of the most advanced VoIP protocols and unlike its predecessors, which were modeled after traditional telephony protocols, SIP has the ability to scale with a distributed architecture and at a lower cost. SIP's superior attributes also include faster and more cost effective development and lower hardware requirements, which allows us to incur lower capital expenditure costs. During 2003, we intend to continue to expand our offerings on this network. At the same time, we continue to build our SIP expertise through relationships with other SIP leaders such as Cisco and Microsoft.

Backbone

Our network is built around a redundant, high availability backbone that connects Los Angeles, New York and London. In each of these locations there are multiple interconnections or peering arrangements with Internet backbone providers. These points are strategically located to allow access from our network to and from the Internet with the best performance. The backbone is based on Cisco routing equipment utilizing Hot Standby Routing Protocol. In order to achieve maximum redundancy, our network has several connections to the public Internet. While operating as a private extension of the Internet, the backbone has a high level of security designed to isolate it from security threats found on the public Internet.

Origination Access

Access to our network is possible through several points. Users may access services through PSTN connections (toll free and local access). Carrier transmission access is aggregated through our switch in New York or through any one of our POPs directly. Call origination is possible from the PC-to-Phone product, using our downloadable software client or using a Web browser, Microsoft Messenger or Broadband Phone. These calls enter our network from the Internet through our interconnect points with the Internet. We carefully manage each originating port and utilize innovative capacity planning tools and techniques to provide the best and most cost effective service to customers.

Termination

Our network can terminate calls through any of our POPs and termination providers' POPs. Termination decisions are based on a sophisticated Least Cost Routing system which applies routing rules based on origination point, time of day, termination cost and other factors. These rules are constantly updated to ensure maximum economic and quality efficiency. Our network has termination facilities that enable us to interconnect with multiple carriers. This allows us to refile traffic to our own switch, giving us the ability to route calls to virtually anywhere in the world. Each termination port is carefully managed with innovative capacity planning tools and techniques to provide the best and most cost effective service to customers, along with multiple termination options to ensure the highest possible levels of redundancy.

Network Services

Our network supports several application building services on the network level, including:

Programmable Interactive Voice Response (PIVR). Our network is capable of playing a configurable voice prompt to enable it to provide applications such as pre-paid calling cards. PIVR services are highly programmable and can be customized to fulfill a variety of customer needs. The configuration of the PIVR is controlled from a central location, enabling efficient management and faster maintenance in the event of malfunctions.

Real Time AAA. We are able to authenticate, authorize and account (AAA) for inbound services through the network's real time radius protocol. Whether services are pre-paid or post-paid, the network will disconnect the call when the user's account balance runs out. These protocols interface with the billing system to rate the calls correctly and allow access to permitted services only. Authentication may be customized to utilize numbers, textual strings, credit card numbers and more.

Reporting Tools. All network services are accounted for in real time, generating Call Detail Records. These records are aggregated in real time to both the billing systems, for rating, and to the data warehouse, which provides access to the information by the marketing, financial, capacity planning and operational groups through a client or Web interface using advanced OLAP cubes.

The Network Operations Center (NOC). Our NOC monitors and manages our network from a central location, seven days a week, 24 hours a day. The NOC monitors all aspects of our network, including the routers, databases, switches, leased lines, Internet connections, gatekeepers and gateways, to ensure that they are functioning at optimal

levels. In the event of a failure of any of these network components, NOC personnel are provided with a real time, systems generated notification via an instant messaging system consisting of pagers, cellular phones, screen pop-ups and e-mail, which identifies the malfunction so that proper measures can be taken to restore service in a timely fashion. Our NOC utilizes a combination of proprietary and leading industry technologies, including Hewlett-Packard Open View software and Ericsson IPT management console, as well as unique applications developed by us. The NOC serves all of the different parts of our operations environment, including network nodes, Web servers and specific applications.

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

Proprietary Rights

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

We have registered trademarks for "deltathree™" and "iConnectHere.com™" in the United States. However, these trademarks may not provide adequate protection against competitive technology and may not be held valid and enforceable if challenged. We do not own any registered copyrights.

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

Regulatory Environment

Regulation of IP Telephony

The use of the Internet and private IP networks to provide telephone service is a recent market development. While the provision of voice communication services over the Internet and private IP networks is currently permitted under United States law, some foreign countries have laws or regulations that may prohibit voice communications over the Internet or using private IP networks. Increased regulation of the Internet may slow its growth, particularly if many countries impose restrictive regulations. Increased regulation of the Internet and/or IP telephony providers or the prohibition of Internet and IP telephony in one or more countries, more aggressive enforcement of existing regulations in such countries or our failure or the failure of our network partners to comply with applicable regulations could materially adversely affect our business, financial condition, operating results and future prospects.

United States. Based on information users provide to us when they signed up to use our services, we estimate that approximately 60% of our IP communications services are provided to carriers or users in the United States. We believe that, under United States law, based on specific regulatory classifications and recent regulatory decisions, the IP communications services that we provide constitute information services (as opposed to regulated telecommunications services). As such, our services are not currently regulated by the Federal Communications Commission (FCC) or state agencies charged with regulating telecommunications carriers. Nevertheless, aspects of our operations may be subject to state or federal regulation, including regulation governing universal service funding, payment of access charges, disclosure of confidential communications and tax issues. However, we cannot assure you that our services will not be regulated in the future. Several efforts have been made in the United States to enact federal legislation that would either regulate or exempt from regulation communications services provided over the Internet.

In addition, the FCC is currently considering reforms to universal service funding and may consider whether to impose various types of charges or other common carrier regulations upon some providers of Internet and IP telephony. The FCC stated in April 1998 that it did not have an adequate record on which to make a definitive ruling, but that the record suggested that certain forms of phone-to-phone IP telephony appear to have the same functionality as non-IP telecommunications services and lack the characteristics that would render them information services. More recently, the FCC has stated that the development of new technologies, such as IP telephony, may increase the strain on universal service funding. In that regard, the FCC is currently reviewing whether to extend universal service obligations to non-traditional providers such as facilities-based providers of broadband Internet services.

Two other carriers have asked the FCC to make definitive rulings regarding the classification of their IP telephony services. Thus, the regulatory classification issue is now before the FCC, although only in the context of these two specific service offerings. However, the FCC has indicated that it plans to address the regulatory and compensation issues posed by IP telephony services in the near future. Any ruling by the FCC on the regulatory considerations affecting Internet and IP telephony services will affect our operations and revenues.

If the FCC were to determine that certain services are subject to FCC regulations as telecommunications services, the FCC might require providers of Internet and IP telephony services to be subject to traditional common carrier regulation, make universal service contributions and/or pay access charges. It is also possible that the FCC may adopt a regulatory framework other than traditional common carrier regulation, which would apply to Internet and IP telephony providers.

State regulatory authorities may also retain jurisdiction to regulate the provision of, and impose charges on, intrastate Internet and IP telephony services. Several state regulatory authorities have initiated proceedings to examine the regulation of such. The majority of states that have looked at the regulation of IP telephony services have deferred consideration of the issue pending the outcome of the FCC's proceedings. Although, at least one state has ordered that access charges apply to the termination of IP telephony calls. In addition, several state commissions have participated in the FCC's proceedings and have advocated imposing traditional common carrier regulation on Internet and IP telephony providers.

International. The regulatory treatment of Internet and IP telephony outside of the United States varies widely from country to country. A number of countries that currently prohibit competition in the provision of voice telephony may also prohibit Internet and IP telephony. Other countries permit, but regulate Internet and IP telephony. Some countries will evaluate proposed Internet and IP telephony service on a case-by-case basis and determine whether it should be regulated as a voice service or as another telecommunications service. Finally, in many countries Internet and IP telephony has not yet been addressed by legislation or regulatory action.

With respect to the European Union, we believe that our services fall outside the classification of regulated voice telephony services. The current European Union regulatory regime distinguishes between voice telephony services and other telecommunications services. In January 1998 and again in December 2000, the European Commission concluded that IP telephony did not at that time meet the definition of "voice telephony" subject to member state's regulation. However, the Commission noted that some forms of IP telephony could be considered voice telephony, for example, where an IP telephony service is marketed as an alternative form of voice telephony service, users can dial out to any telephone number, and the provider guarantees the quality of the IP voice service by bandwidth reservation and claims that the quality of the IP voice service is the same as traditional voice telephony service.

A determination by the European Commission that IP telephony constitutes "voice telephony" may trigger significant regulatory consequences with respect to, among other things, licensing requirements and contributions to universal service funding. In addition, the Commission has adopted directives for a new framework for electronic communications regulation that, in part, attempt to harmonize the regulations that apply to services regardless of the technology used by the provider. We cannot predict what future actions the European Commission may take regarding IP telephony and related matters, or what impact, if any, such actions may have on our business.

Based on the Commission's current position, we believe that providers of IP telephony should be subjected to no more than a general authorization or declaration requirement by the European Union Member States. The Member States of the European Union are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden and the United Kingdom. However, since the Commission's findings on IP telephony are not binding on the Member States, we cannot assure you that the services provided over our network will not be deemed "voice telephony" subject to heightened regulation by one or more EU Member States.

As we make our services available in foreign countries, and as we facilitate sales by our network partners to end users located in foreign countries, such countries may claim that we are required to qualify to do business in the particular foreign country. Such countries may also claim that we are subject to regulation, including requirements to obtain authorization for the provision of voice telephony or other telecommunications services, or for the operation of telecommunications networks. It is also possible that such countries may claim that we are prohibited in all cases from providing our services or conducting our business as conducted in those countries.

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

Other Regulation Affecting the Internet

United States. Congress has recently adopted legislation that affects certain aspects of the Internet, including on-line content, user privacy, national security and taxation. For example, the extension of the Internet Tax Freedom Act prohibits certain taxes on Internet uses through November 1, 2003. We cannot predict whether substantial new taxes will be imposed on our services after that date. In addition, Congress, the FCC and other federal entities are considering other legislative and regulatory proposals that would further affect the Internet, including with regard to broadband networks used to support high-speed Internet access services. Congress is, for example, currently considering legislation on a wide range of issues including Internet spamming, database privacy, gambling, pornography and child protection, Internet fraud and privacy. Various states have adopted and are considering Internet-related legislation.

International. The European Union has also enacted several directives relating to the Internet. The European Union has, for example, adopted a directive on data protection that imposes restrictions on the processing of personal data. Under the directive, personal data may not be collected, processed, used for other purposes or transferred outside the European Union unless certain specified conditions are met. In addition, persons whose personal data is processed within the European Union are guaranteed a number of rights. The directive may affect companies that collect or transmit information over the Internet from individuals in the European Union Member States. In particular, companies with establishments in the European Union may not be permitted to transfer personal data to countries that do not maintain adequate levels of data protection.

In addition, the European Union has adopted a separate, complementary privacy directive that pertains to the telecommunications sector. This directive establishes certain requirements with respect to, among other things, the confidentiality, processing and retention of subscriber traffic and billing data, security of services and networks, subscriber rights to non-itemized bills, and the presentation and restriction of calling and connected line identification. In addition, a number of European countries outside the European Union have adopted, or are in the process of adopting, rules similar to those set forth in the European Union directives. Although we do not engage in the collection of data for purposes other than routing calls and billing for our services, the data protection directives are quite broad and the European Union privacy standards are stringent. Accordingly, the potential effect of these data protection rules on the development of our business is uncertain.

Competition

We compete primarily in the market for enhanced IP communications services. This market is highly competitive and has numerous service providers.

The market for enhanced Internet and IP communications services is new and rapidly evolving. We believe that the primary competitive factors determining our success, in the Internet and IP communications market are:

- quality of service;
- the ability to meet and anticipate customer needs through multiple service offerings;
- responsive customer care services;
- price.

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

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

Traditional Telecommunications Carriers. Several traditional telecommunications companies, including industry leaders such as AT&T, Sprint, Deutsche Telekom, WorldCom and Qwest Communications International, have announced their intention to offer enhanced Internet and IP communications services in both the United States and internationally. All of these competitors are significantly larger than we are and have:

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

These and other competitors may be able to bundle services and products that are not offered by us together with enhanced Internet and IP communications services, which could place us at a significant competitive disadvantage. Many of our competitors enjoy economies of scale that can result in lower cost structure for transmission and related costs, which could cause significant pricing pressures within the industry.

Employees

As of December 31, 2002, we employed 69 full-time and 27 part-time employees, of which 77 were located in Israel, and 19 were located in New York. We consider our relationship with our employees to be good. None of our employees is covered by collective bargaining agreements.

Generally, all male adult citizens and permanent residents of Israel under the age of 51 are, unless exempt, obligated to perform up to 31 days of military reserve duty annually. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. Some of our officers and employees are currently obligated to perform annual reserve duty. While we have operated effectively under these requirements since we began operations, no assessment can be made as to the full impact of such requirements on our workforce or business if conditions should change, and no prediction can be made as to the effect on us of any expansion of such obligations.

ITEM 2. PROPERTIES

We maintain our executive offices at 75 Broad Street, New York, New York under a lease with an annual rent of approximately \$650,000, increasing annually to \$870,000 during the final year of the lease. The lease term extends until July 2010, with an option to extend the lease for an additional five years.

We lease a 1,440 square meter office, which houses our research and development facilities, at the Jerusalem Technology Park, Jerusalem, Israel at an annual cost of \$ 292,000. The lease term that expired in February 2003 contained an option to extend the lease for an additional five years. In June 2002 we signed an extension agreement for additional three years, commencing February 2003, at an annual cost of \$201,600, for 1,056 square meters, with the remaining 384 square meters to be returned to the building owner.

ITEM 3. LEGAL PROCEEDINGS

On October 8, 1999, Aerotel, Ltd. and Aerotel U.S.A. commenced a suit against us, RSL COM and an RSL COM subsidiary in the United States District Court for the Southern District of New York. Aerotel alleges that we are infringing on a patent issued to Aerotel in November 1987 by making, using, selling and offering for sale prepaid telephone card products in the United States. Aerotel seeks an injunction to stop us from using the technology covered by this patent, monetary damages in an unspecified amount and reimbursement of attorneys' fees. We have answered the complaint, the parties engaged in pre-trial discovery, and the case remains at a preliminary stage. We believe that we have meritorious defenses to the claims and we intend to defend the lawsuit vigorously. However, the outcome of the litigation is inherently unpredictable and an unfavorable result may have a material adverse effect on our business, financial condition and results of operations. Regardless of the ultimate outcome, the litigation could result in substantial expenses to us and significant diversion of efforts by our managerial and other personnel.

We, as well as certain of our former officers and directors, have been named as defendants in a number of purported securities class actions in Federal District Court for the Southern District of New York, arising out of our initial public offering in November 1999 (the "IPO"). Various underwriters of the IPO also are named as defendants in the actions. The complaints allege, among other things, that the registration statement and prospectus filed with the Securities and Exchange Commission for purposes of the IPO were false and misleading because they failed to disclose that the underwriters allegedly (i) solicited and received commissions from certain investors in exchange for allocating to them shares of our stock in connection with the IPO and (ii) entered into agreements with their customers to allocate such stock to those customers in exchange for the customers agreeing to purchase additional shares in the aftermarket at predetermined prices. On August 8, 2001, the court ordered that these actions, along with hundreds of IPO allocation cases against other issuers, be transferred to Judge Scheindlin for coordinated pre-trial proceedings. In July 2002, omnibus motions to dismiss the complaints based on common legal issues were filed on behalf of all issuers and underwriters. On February 19, 2003, the Court issued an opinion granting in part and denying in part those motions to dismiss. The complaint against the Company was not dismissed as a matter of law. These cases remain at a preliminary stage and no discovery proceedings have taken place. We believe that the claims asserted against us in these cases are without merit and intend to defend ourselves vigorously against them.

On February 12, 2003 we announced that four lawsuits had been filed against us, our officers and directors, and our majority stockholder, Atarey Hasharon Chevra Lepituach Vehashkaot Benadlan (1991) Ltd. ("Atarey"), in connection with our formation of the special committee to evaluate the proposal by Atarey to purchase all of our outstanding shares of common stock not held by Atarey and its affiliates. On February 6, 2003, we issued a press release in connection with the proposed transaction. The lawsuits purport to be class actions on behalf of our public stockholders. The plaintiffs in these actions have asserted a variety of claims, including allegations that Atarey's

proposed tender offer price for our publicly held shares is unfair and grossly inadequate; and that our officers and directors have breached their fiduciary duties to the public stockholders. Each of the lawsuits has been filed in the Delaware Court of Chancery in and for New Castle County. We do not believe that these lawsuits state valid claims against us or any of our officers or directors.

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

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

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is currently listed on the Nasdaq SmallCap Market under the symbol "DDDC". The listing of our common stock was transferred from the Nasdaq National Market to the Nasdaq SmallCap Market effective on September 17, 2002. Our common stock had traded on the Nasdaq National Market under the symbol "DDDC" since November 22, 1999. We currently meet all criteria for continued inclusion in the Nasdaq SmallCap Market except for the \$1.00 minimum bid price per share requirement. We currently have a grace period until September 1, 2003 to demonstrate a closing bid price of at least \$1.00 for a minimum of ten consecutive trading days, provided we can demonstrate that we remain in compliance with the Nasdaq SmallCap Market's initial listing standards, based on Nasdaq's most recent rules. Nasdaq regulations allow for the transfer back to the Nasdaq National Market should we maintain a minimum bid price of \$1.00 for at least 30 consecutive trading days by September 1, 2003, and comply at all times with other applicable continued listing requirements for the Nasdaq National Market.

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

	<u>High</u>	<u>Low</u>
Year ended December 31, 2000		
First quarter	\$62.38	\$18.00
Second quarter	21.38	5.75
Third quarter	15.00	3.56
Fourth quarter	5.44	1.19
Year ended December 31, 2001		
First quarter	3.50	1.03
Second quarter	1.61	0.60
Third quarter	0.98	0.26
Fourth quarter	0.93	0.52
Year ended December 31, 2002		
First quarter	1.25	0.75
Second quarter	1.08	0.60
Third quarter	0.63	0.34
Fourth quarter	0.90	0.37
Year ended December 31, 2003		
First quarter (through March 27 th , 2003)	0.68	0.48

On March 27, 2003, the last reported sale price for our common stock on the Nasdaq SmallCap Market was \$0.55 per share. The market price for our stock is highly volatile and fluctuates in response to a wide variety of factors.

Holdings

As of March 27, 2003, we had approximately 129 holders of record of our common stock. This does not reflect persons or entities who hold their stock in nominee or "street" name through various brokerage firms.

Dividend Policy

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

Equity Compensation Plan Information

The following table provides certain aggregate information with respect to all of our equity compensation plans in effect as of December 31, 2002:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in first column)
Equity Compensation Plans Approved by Security Holders (1)	3,449,520	\$2.87	550,480
Equity Compensation Plans not Approved by Security Holders	N/A	N/A	N/A
Total	3,449,520	\$2.87	550,480

(1) These plans consist of our 1999 Stock Incentive Plan, 1999 Directors' Plan, and 1999 Employee Stock Purchase Plan.

Recent Sales of Unregistered Securities

None.

Use of Proceeds

On November 22, 1999, we offered 6,000,000 shares of our common stock in an initial public offering. These shares were registered with the Securities and Exchange Commission on a registration statement on Form S-1 (file no. 333-86503), which became effective on November 22, 1999. We received net proceeds of approximately \$96,255,000 from the sale of 6,900,000 shares at the initial public offering price of \$15.00 per share after deducting underwriting commissions and discounts and expenses of approximately \$6,300,000. The managing underwriters for our initial public offering were Lehman Brothers Inc., Merrill Lynch & Co., U.S. Bancorp Piper Jaffray, Lazard Frères & Co. LLC and Fidelity Capital Markets.

Through December 31, 2002, we used approximately \$33 million of the net proceeds for sales, marketing and promotional activities, \$20 million for capital expenditures and \$13 million for general corporate purposes. Pending use of the remaining net proceeds, we have invested the remaining net proceeds in interest-bearing, investment-grade instruments, certificates of deposit, or direct or guaranteed obligations of the United States.

ITEM 6. SELECTED FINANCIAL DATA

We derived the selected consolidated financial data presented below from our consolidated financial statements and related notes included in this annual report. You should read the selected consolidated financial data together with our consolidated financial statements and related notes and the section of this annual report entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations." Brightman Almagor & Co., a member firm of Deloitte Touche, independent certified public accountants, audited our historical financial statements since inception and as of and for the years ended December 31, 1998, 1999, 2000, 2001 and 2002. Their report appears elsewhere in this annual report.

	Year Ended December 31,				
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
	(In thousands, except share data)				
Statement of Operations Data:					
Revenues:					
Affiliates	\$3,896	\$7,431	\$13,977	\$1,669	\$-
Non-affiliates.....	1,742	3,621	16,399	13,991	12,929
Total revenues	5,638	11,052	30,376	15,660	12,929
Costs and operating expenses:					
Cost of revenues, net	(4,459)	(9,723)	(24,932)	(13,486)	(8,934)
Research and development expenses, net	(650)	(1,233)	(6,625)	(5,648)	(3,435)
Selling and marketing expenses	(2,431)	(7,403)	(20,548)	(7,800)	(3,910)
General and administrative expenses (exclusive of non-cash compensation expense)	(1,842)	(2,754)	(6,694)	(6,982)	(2,158)
Non-cash compensation expense	(743)	(19,116)	(6,331)	(825)	(270)
Depreciation and amortization	(2,671)	(3,721)	(7,919)	(8,996)	(6,606)
Write-down of fixed assets.....	-	-	-	(1,003)	-
Expenses due to cancellation of supplier agreement	-	-	-	(3,628)	-
Impairment of goodwill.....	-	-	(8,905)	(4,151)	-
Total costs and operating expenses.....	(12,796)	(43,950)	(81,954)	(52,519)	(25,313)
Loss from operations.....	(7,158)	(32,898)	(51,578)	(36,859)	(12,384)
Interest income (expense), net.....	(186)	(873)	3,632	1,677	448
Minority interest.....	223	-	-	-	-
Income taxes.....	-	-	(311)	(552)	(141)
Net loss	\$(7,121)	\$(33,771)	\$(48,257)	\$(35,734)	\$(12,077)
Net loss per share – basic and diluted.....	\$(0.37)	\$(1.65)	\$(1.67)	\$(1.23)	\$(0.42)
Weighted average shares outstanding – basic and diluted.....	19,254	20,418	28,833	29,035	28,886
	Year Ended December 31,				
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
	(In thousands)				
Balance Sheet Data:					
Cash and cash equivalents	\$1,357	\$89,957	\$20,857	\$13,583	\$5,681
Short-term investments.....	-	11,276	30,542	14,192	15,552
Working capital (deficiency).....	(3,232)	82,942	43,538	23,374	17,675
Total assets	25,676	126,832	86,169	45,869	32,197
Long-term debt due to affiliates.....	5,107	-	-	-	-
Total stockholder's equity (deficiency).....	12,370	102,580	72,479	38,921	27,114

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

The following discussion of our financial condition and results of operations should be read together with our consolidated financial statements and the related notes thereto included in another part of this annual report. This discussion contains certain forward-looking statements that involve substantial risks and uncertainties. When used in this report the words "anticipate," "believe," "estimate," "expect" and similar expressions as they relate to our management or us are intended to identify such forward-looking statements. Our actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. Historical operating results are not necessarily indicative of the trends in operating results for any future period.

Overview

We are a provider of integrated Voice over Internet Protocol (VoIP) telephony services. We were founded in 1996 to capitalize on the growth of the Internet as a communications tool by commercially offering Internet Protocol (IP) telephony services. IP telephony is the real time transmission of voice communications in the form of digitized "packets" of information over the Internet or a private network, similar to the way in which e-mail and other data is transmitted. Our business currently includes the provision of enhanced Web-based and other communications services to individual consumers, under our iConnectHere brand name, the provision of a total "Hosted Communications Solution" that enables corporate customers and service providers to offer private label telecommunications to their customer bases, and the transmission of voice and data traffic for communications carriers.

Prior to 1999, our focus was to build a privately-managed, global network utilizing IP technology. 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 Web site. 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 early 2001, we deployed our Broadband Phone offering – a complete phone replacement solution available to business and consumer customers over the "last mile" through broadband connections via cable modem, DSL or fixed wireless. In 2001, we also announced the launch of our state-of-the-art SIP (Session Initiation Protocol) infrastructure, and we became one of the first service providers to have built an end-to-end SIP network. During 2002, our continuing SIP efforts resulted in our launch of our SIP-based dialer. These efforts are designed to position us as a leading provider of VoIP services.

Factors Affecting Future Results

Industry and 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; the development of new supply sources; supply disruptions; technological advances, including advances in telecommunications technology and advances in technology relating to telecommunications usage; changes in demographics, including population growth rates and consumer preferences; and the competitiveness of alternative telecommunications sources or product substitutes. Currently, the economy in general and the telecommunications industry in particular are suffering. A number of the leading telecommunications companies have seen their market capitalizations decrease dramatically and some have filed for bankruptcy protection. As a result, raising capital has become extremely difficult, there is extreme pressure on the pricing of telecommunications services and potential customers and partners have sharply cut back on expenditures, all of which impact us.

Competitive Factors: The telecommunications industry is highly competitive. There is competition within the traditional telecommunications marketplaces (landline and wireless) and also with other emergent "next generation" telecommunications providers, including IP telecommunications providers in supplying the overall telecommunications needs of businesses and individual consumers. We compete with other telecommunications firms in the sale and

purchase of various products and services in many national and international markets and employ all methods of competition which are lawful and appropriate for such purposes. A key component of our competitive position, particularly given the commodity-based nature of many of our products, is our ability to manage operating expenses successfully, which requires continuous management focus on reducing unit costs and improving efficiency.

Political Factors: Our operations and earnings have been, and may in the future be, affected from time to time in varying degree by political instability and by other political developments and laws and regulations, such as forced divestiture of assets; restrictions on production, imports and exports; war or other international conflicts; civil unrest and local security concerns that threaten the safe operation of company facilities; price controls; tax increases and retroactive tax claims; expropriation of property; cancellation of contract rights; and telecommunications regulations. Both the likelihood of such occurrences and their overall effect upon us vary greatly from country to country and are not predictable.

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.

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

Revenues

Prior to June 28, 2001, our majority shareholder was RSL COM, a large telecommunications provider, who was also our largest customer. As such, for financial reporting purposes for fiscal year 2001 and prior years, revenues were derived from affiliates and non-affiliates. Revenues from affiliates consist of revenues received from RSL COM for the carrier transmission and calling card services we provided to RSL COM, prior to Atarey’s acquisition of RSL COM’s holdings of our stock. The majority of the services we provided to RSL COM were resold by RSL COM to other communications companies, and the remainder were used directly by RSL COM’s customers. Carrier transmission services to RSL COM accounted for 0% of our total revenues in 2002 and 10.7% of our total revenues in 2001.

Revenues from non-affiliates consist of revenues from end-users of our enhanced IP communications services, including PC-to-Phone and Phone-to-Phone, which are generated by our both our consumer offering, iConnectHere, and our Hosted Communications Solution, and revenues from carriers other than RSL COM for carrier transmission services. All revenues are recognized as the services are performed. The provision of enhanced IP communications services (primarily PC-to-Phone) through iConnectHere accounted for 43.3% and 32.7% of our total revenues in 2002 and 2001, respectively, while the provision of enhanced IP communications services through our Hosted Communications Solution sales efforts accounted for 16.9% and 22.1% of our total revenues in 2002 and 2001, respectively. Carrier transmission services to non-affiliates accounted for 10.9% and 11.2% of our total revenues in 2002 and 2001, respectively.

Costs and Operating Expenses

Costs and operating expenses consist of cost of revenues, research and development expenses, selling and marketing expenses, general and administrative expense, depreciation and amortization of goodwill, non-cash stock compensation, write-down of fixed assets, expenses due to cancellation of agreement with a supplier and impairment of goodwill related expenses.

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

- Research and development expenses consist primarily of costs associated with establishing our network and the initial testing of our services and compensation expenses of software developers involved in new product development and software maintenance. In the future, these expenses may fluctuate as a percentage of revenue depending on the project undertaken during the reporting period. Since our inception, we have expensed all research and development costs in each of the periods in which they were incurred.
- Selling and marketing expenses consist primarily of advertising and promotional expenses incurred to attract potential consumer users of iConnectHere and expenses associated with our direct sales force incurred to attract potential business customers and service providers for our Hosted Communications Solution. We expect to decrease our overall selling and marketing expenses as we focus our attention on growing the percentage of sales related to our Hosted Communications Solution. We anticipate that as we add new paid users we will be able to spread these costs over a larger revenue base and accordingly improve our operating margins.
- General and administrative expenses consist primarily of compensation and benefits for management, finance and administrative personnel, occupancy costs and legal and accounting fees, as well as the expenses associated with being a public company, including the costs of directors' and officers' insurance.

We have not recorded any income tax benefit for net losses and credits incurred for any period from inception to December 31, 2002. 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, we have recorded a full valuation allowance with respect to these deferred assets.

We recognized \$6.3 million in non-cash compensation expense in 2000, \$825,000 in 2001, and \$270,000 in 2002.

Critical Accounting Policies

Our established policies are outlined in the footnotes to the Consolidated Financial Statements (contained in Part IV, Item 15 of this Form 10-K) entitled "Note 2 - Summary of significant accounting policies". As part of its oversight responsibilities, our management evaluates the propriety of its accounting methods as new events occur. We believe that our policies are applied in a manner which provides the reader of our financial statements a current, accurate and complete presentation of information in accordance with U.S. Generally Accepted Accounting Principles. Principal accounting practices that require the use of assumptions and judgments are outlined below:

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

Expenses: Cost of revenues is comprised primarily of access, transmission and termination costs based on actual minutes in addition to monthly circuit lease costs and is net of reimbursements from vendors. Research and development expenses, net of reimbursements from vendors, are expensed as incurred. Advertising expenses are expensed as incurred.

Long-lived Assets: Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the depreciable assets, which range from two to five years. Improvements are capitalized, while repair and maintenance costs are charged to operations as incurred. In accordance with SFAS 121, our long-lived assets are reviewed for impairment on a quarterly basis and whenever events or changes in circumstances occur indicating that the net carrying amount may not be recoverable. We review for impairment by comparing the carrying value of the long-lived asset to the estimated undiscounted future cash flows expected to result from the use of the long-lived assets (and their eventual disposition). If the sum of the expected undiscounted

future cash flows is less than the carrying amount of assets, we would recognize an impairment loss. The impairment loss, if determined to be necessary, would be measured as the amount by which the carrying amount of the long-lived asset exceeds the fair value of the long-lived asset based on estimated future discounted cash flows. Effective December 1, 2001, we adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (SFAS 144) which addresses financial accounting and reporting for the recognition and measurement of impairment and disposal of long-lived assets. SFAS 144 supersedes SFAS No. 121. The adoption of SFAS 144 did not have a material effect on our consolidated financial position or results of operations.

Results of Operations

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

	<u>2000</u>	<u>2001</u>	<u>2002</u>
	<u>Year Ended December 31,</u>		
Revenues:			
Affiliates	46.0%	10.7%	0.0%
Non-affiliates	<u>54.0</u>	<u>89.3</u>	<u>100.0</u>
Total revenues.....	100.0	100.0	100.0
Costs and operating expenses:			
Cost of revenues, net	82.1	86.0	69.1
Research and development expenses, net	21.8	36.0	26.6
Selling and marketing expenses	67.6	49.8	30.2
General and administrative expenses (exclusive of non-cash compensation expense)	22.0	44.6	16.7
Non-cash compensation expense	20.8	5.3	2.1
Depreciation and amortization	26.1	57.4	51.1
Write down of fixed assets	-	6.4	0.0
Expenses due to cancellation of supplier agreement	-	23.2	0.0
Impairment of goodwill.....	<u>29.3</u>	<u>26.5</u>	<u>0.0</u>
Total costs and operating expenses	<u>269.8</u>	<u>335.3</u>	<u>195.8</u>
Loss from operations	(169.8)	(235.3)	(95.8)
Interest income (expense), net	12.0	10.7	3.5
Income taxes	<u>1.0</u>	<u>(3.5)</u>	<u>(1.1)</u>
	<u>(158.9)%</u>	<u>(228.2)%</u>	<u>(93.4)%</u>

Comparison of 2002 and 2001

Revenues

Affiliates. There were no revenues from affiliates in 2002, compared to \$1.7 million in 2001. The decrease in revenues from affiliates was due to the sale of all of our Class B Common Stock, representing majority ownership of us, on June 29, 2001 by RSL Communications, Ltd. ("RSL COM") and our disconnection from the RSL COM network. After June 29, 2001, there were no further revenues from affiliates, and we do not anticipate receiving revenues from affiliates in the future.

Non-affiliates. Revenues from non-affiliates decreased approximately \$1.1 million or 7.9% to approximately \$12.9 million in 2002 from approximately \$14.0 million in 2001. Revenues from enhanced IP communications services (including our Hosted Communications Solution) decreased by approximately \$0.7 million or 5.7% to approximately \$11.5 million in 2002 from approximately \$12.2 million in 2001, due to a lesser number of new Hosted Communications Solution partners, yielding lower up-front integration fees, and partially offset by a greater number of PC-to-Phone and Phone-to-Phone calls being placed by an increasing user base.

Revenues from carrier transmission services, for telecommunications carriers other than RSL COM, decreased by approximately \$0.4 million or 22.2% to approximately \$1.4 million in 2002 from approximately \$1.8 million in 2001, due primarily to decreased demand from a smaller customer base. No customer (other than RSL COM in 2001) accounted for greater than 10% of our revenues during these periods.

Costs and Operating Expenses

Cost of revenues. Cost of revenues decreased by \$4.6 million or 34.1% to \$8.9 million in 2002 from \$13.5 million in 2001, due primarily to a decrease in the amount of traffic being terminated.

Research and development expenses. Research and development expenses decreased by \$2.2 million or 39.3% to \$3.4 million in 2002 from \$5.6 million in 2001, due to lower personnel costs associated with the development of new services and enhancements to our existing services.

Selling and marketing expenses. Selling and marketing expenses decreased by \$3.9 million or 50.0% to \$3.9 million in 2002 from \$7.8 million in 2001, due to a significant decrease in branding and promotional activities.

General and administrative expenses. General and administrative expenses decreased by \$4.8 million or 68.6% to \$2.2 million in 2002 from \$7.0 million in 2001, primarily due to decreased personnel and occupancy costs.

Non-cash compensation expenses. Non-cash compensation expenses decreased by \$0.5 million or 62.5% to \$0.3 million in 2002 from \$0.8 million in 2001, due to our impairment of goodwill during 2001. Consequently, there were no goodwill related expenses during 2002.

Depreciation and amortization of goodwill. Depreciation and amortization of goodwill increased by \$2.4 million or 26.7% to \$6.6 million in 2002 from \$9.0 million in 2001, due to our on-going purchase, and subsequent depreciation of fixed assets.

Loss from Operations

Loss from operations decreased by \$24.5 million or 66.4% to \$12.4 million in 2002 from \$36.8 million in 2001, due primarily to the decrease in costs and operating expenses, including non-cash compensation expenses and selling and marketing expenses. We expect to continue to incur losses for the foreseeable future.

Interest (Expense) Income, Net

Interest income decreased by \$1.3 million or 76.5% to \$0.4 million in 2002 from \$1.7 million in 2001, due primarily to lower interest rates earned on a reduced balance of remaining proceeds from our initial public offering.

Income Taxes, Net

We paid net income taxes of \$0.1 million in 2002 compared to \$0.6 million in 2001.

Net Loss

Net loss decreased \$23.6 million or 66.1% to \$12.1 million in 2002 from \$35.7 million in 2001, due to the foregoing factors.

Comparison of 2001 and 2000

Revenues

Affiliates. Revenues from affiliates decreased by \$12.3 million or 87.9% to \$1.7 million in 2001 from \$14.0 million in 2000, due to the sale of all of our Class B Common Stock on June 29, 2001 by RSL COM to Atarey and our disconnection from the RSL COM network. After June 29, 2001, there were no further revenues from affiliates, and we do not anticipate receiving revenues from affiliates in the future.

Non-affiliates. Revenues from non-affiliates decreased by \$2.4 million or 14.6% to \$14.0 million in 2001 from \$16.4 million in 2000. Revenues from enhanced IP communications services (including our Hosted Communications Solution) decreased by \$1.4 million or 10.3% to \$12.2 million in 2001 from \$13.6 million in 2000, due to a lesser number of new Hosted Communications Solution partners, yielding lower up-front integration fees, partially offset by a greater number of PC-to-Phone and Phone-to-Phone calls being placed by an increasing user base. Revenues from carrier transmission services for telecommunications carriers other than RSL COM decreased by \$1.0 million or 35.7% to \$1.8 million in 2001 from \$2.8 million in 2000, due primarily to decreased demand from a smaller customer base.

Revenues from carrier transmission services to RSL COM and other telecommunications carriers accounted for 19.5% and 25.3% of revenues in 2001 and 2000, respectively. As revenues from our enhanced IP communication services continue to grow as a percentage of total revenue, we expect that our revenues from carrier transmission services will continue to account for a declining percentage of our revenues. Other than RSL COM, no other customer accounted for greater than 10% of our revenues during these periods.

Costs and Operating Expenses

Cost of revenues. Cost of revenues decreased by \$11.4 million or 45.8% to \$13.5 million in 2001 from \$24.9 million in 2000, due primarily to a decrease in the amount of traffic being terminated.

Research and development expenses. Research and development expenses decreased by \$1.0 million or 15.2% to \$5.6 million in 2001 from \$6.6 million in 2000, due to lower personnel costs associated with the development of new services and enhancements to our existing services.

Selling and marketing expenses. Selling and marketing expenses decreased by \$12.8 million or 62.1% to \$7.8 million in 2001 from \$20.6 million in 2000, due to a significant decrease in branding and promotional activities.

General and administrative expenses. General and administrative expenses increased by \$0.3 million or 4.5% to \$7.0 million in 2001 from \$6.7 million in 2000, primarily due to increased personnel and occupancy costs.

Non-cash compensation expenses. Non-cash compensation expenses decreased by \$5.5 million or 87.3% to \$0.8 million in 2001 from \$6.3 million in 2000, due to the completed amortization of costs incurred during 1998. Remaining amortization of costs related to the 1999 grants of options and warrants below the then fair market value will continue to be reflected in future financial statements.

Depreciation and amortization of goodwill. Depreciation and amortization of goodwill increased by \$1.1 million or 13.9% to \$9.0 million in 2001 from \$7.9 million in 2000, due to our on-going purchase, and subsequent depreciation of fixed assets.

Impairment of goodwill. We incurred a one-time expense of \$4.2 million for the year ended December 31, 2001 related to the impairment of goodwill. This one-time charge was due to the write-off of 'pushed-down' goodwill associated with the acquisition of us by RSL COM, the valuation of which was impacted by the sale of majority ownership by RSL COM to Atarey. We incurred a one-time expense of \$8.9 million for the year ended December 31, 2000 related to the impairment of goodwill. This one-time charge was due to the write-off of goodwill associated with the technology acquired through our acquisition of Yourday.com, which was not incorporated into iConnectHere as originally planned.

Write down of fixed assets from RSL sale. We incurred a one-time expense of approximately \$7.0 million from the write down of equipment that was purchased in previous periods to support contracts and inter-company agreements between us and RSL COM that were cancelled at the time of RSL COM's sale of its majority ownership interest to Atarey. See Note 12 to the accompanying financial statements for further details.

Expenses due to the cancellation of a supplier agreement . We incurred a one-time expense of approximately \$3.6 million that resulted from the cancellation of a development and promotion agreement between CNET and us. Expenses included a payment to terminate the contract and the acceleration of the amortization of compensation charges deferred in previous years.

Loss from Operations

Loss from operations decreased by \$14.7 million or 28.5% to \$36.8 million in 2001 from \$51.5 million in 2000, due primarily to the decrease in costs and operating expenses, including non-cash compensation expenses and selling and marketing expenses. We expect to continue to incur losses for the foreseeable future.

Interest (Expense) Income, Net

Interest income decreased by \$1.9 million or 52.8% to \$1.7 million in 2001 from \$3.6 million in 2000, due primarily to lower interest rates earned on a reduced balance of remaining proceeds from our initial public offering.

Income Taxes, Net

We paid net income taxes of \$0.6 million in 2001 compared to \$0.3 million in 2000.

Net Loss

Net loss decreased \$12.5 million or 25.9% to \$35.7 million in 2001 from \$48.2 million in 2000, due to the foregoing factors.

Liquidity and Capital Resources

Since our inception in June 1996, we have incurred significant operating and net losses due in large part to the start-up and development of our operations. As of December 31, 2002, we had an accumulated deficit of approximately \$139.5 million. We anticipate that we will continue to incur operating and net losses for the foreseeable future.

As of December 31, 2002, we had cash and cash equivalents of approximately \$5.7 million, marketable securities and other short-term investments of approximately \$15.6 million and working capital of approximately \$17.7 million. We generated negative cash flow from operating activities of approximately \$6.2 million during 2002 compared with negative cash flow from operating activities of \$22.7 million during 2001. Accounts receivable were approximately \$0.7 million and \$1.1 million at December 31, 2002 and December 31, 2001, respectively.

Our capital expenditures decreased from approximately \$1.6 million in the year ended December 31, 2001 compared to approximately \$0.4 million in the year ended December 30, 2002, as we better utilize our existing domestic and international network infrastructure.

Short-term, we obtain our funding from our utilization of the remaining proceeds from our initial public offering offset by positive or negative cash flow from our operations. These proceeds are maintained as cash and cash equivalents with an original maturity of three months or less. Based on current trends in our operations, these funds will be sufficient to meet our working capital requirements, including operating losses, and capital expenditure requirements for at least the next fiscal year, assuming that our business plan is implemented successfully, and that:

- our recent revenue trends, which reflected an increase in our higher-margin (primarily PC-to-Phone) products and services continues to increase;
- our expense trends remain at or near the rates of our fourth quarter 2002 rates, which were significantly reduced during the year through reductions in personnel, curtailment of discretionary expenditures, and reduced network rent and termination rates from our carriers; and
- our net cash-burn rate, which was significantly reduced during the year due to the foregoing factors to approximately \$0.8 million in the fourth quarter of 2002, continues to improve throughout 2003 and beyond.

To the extent that these trends do not remain steady, or if in the longer-term we are not able to successfully implement our business strategy we may be required to raise additional funds for our ongoing operations. Additional financing may not be available when needed or, if available, such financing may not be on terms favorable to us, especially in light of current economic conditions and the unfavorable market for telecommunications companies in particular. If additional funds are raised through the issuance of equity securities, our existing stockholders may experience significant dilution. In addition, while the indentures governing outstanding indebtedness of RSL COM were cancelled and no longer restrict our ability to incur indebtedness, we cannot assure you that any third party will be willing or able to provide additional capital on favorable terms or at all.

Contractual Obligations and Commercial Commitments

With the exception of the real estate in ITEM 2. PROPERTIES, and Operating Lease commitments (including automobile leases) of approximately \$190,000 in 2003 and \$140,000 in 2004, we have no other material contractual or commercial commitments for 2003 and thereafter.

Risk Factors

In addition to the other information included in this annual report, you should consider the following risk factors. This annual report contains forward-looking statements covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve risks and uncertainties that may affect our business and prospects. Our results may differ significantly from the results discussed in the forward-looking statements as a result of certain factors that are listed below or discussed elsewhere in this annual report and our other filings with the Securities and Exchange Commission.

Risks Related to Our Company

We Have a History of Losses and Negative Cash Flow and We Anticipate They Will Continue

We have incurred significant losses since inception, and we expect to continue to incur significant losses for the foreseeable future. We reported net losses of approximately \$12.1 million in 2002, approximately \$35.7 million in 2001, and approximately \$48.3 million in 2000. As of December 31, 2002, our accumulated deficit was approximately \$139.5 million. We generated negative cash flow of approximately \$7.9 million during 2002 and \$7.3 million during 2001. As a percentage of revenues, our net loss was 93.4% in 2002, 228.2% in 2001 and 158.9% in 2000. Our revenues may not grow or even continue at their current level. As a result, while we believe we have sufficient funds to meet our working capital requirements for at least the next fiscal year (see – Liquidity and Capital Resources), we will need to increase our revenues significantly to become profitable. In order to increase our revenues, we need to attract and maintain customers to increase the fees we collect for our services. If our revenues do not increase as much as we expect or if our expenses increase at a greater pace than revenues, we may never be profitable or, if we become profitable, we may not be able to sustain or increase profitability on a quarterly or annual basis.

We Will Need Additional Capital to Finance Our Operations in the Future

We intend to continue to enhance and expand our network in order to maintain our competitive position and meet the increasing demands for service quality, capacity and competitive pricing. Also, the introduction of new products and/or service will require significant marketing and promotional expenses that we often incur before we begin to receive the related revenue. While we believe we have sufficient funds to meet our working capital requirements for at least the next fiscal year (see – Liquidity and Capital Resources), if our cash flow from operations is not sufficient to meet our capital expenditure and working capital requirements, we will need to raise additional capital to continue our operations. Especially in light of current economic conditions and the unfavorable market for telecommunications companies in particular, we may not be able to raise additional capital, and if we are able to raise additional capital through the issuance of additional equity, our current investors could experience dilution. If we are unable to obtain additional capital, we may be required to reduce the scope of our business or our anticipated growth, which would reduce our revenues.

We Have a Limited Operating History Upon Which You Can Evaluate Us

We have only a limited operating history upon which you can evaluate our business and prospects. We commenced operations in June 1996. You should consider our prospects in light of the risks, expenses and difficulties we may encounter as an early stage company in the new and rapidly evolving market for IP communications services. These risks include our ability:

- to increase acceptance of our enhanced IP communications services (including our Hosted Communications Solution), thereby increasing the number of users of our IP telephony services;
- to compete effectively;
- to develop new products and keep pace with developing technology.

In addition, because we expect an increasing percentage of our revenues to be derived from our enhanced IP communications services (including our Hosted Communications Solution), our past operating results may not be indicative of our future results.

We May Not be Able to Expand Our Revenue and Achieve Profitability

Our business strategy is to expand our revenue sources to include the provision of enhanced IP communications services to several different customer groups. We can neither assure you that we will be able to accomplish this nor that this strategy will be profitable. Currently, our revenues are primarily generated by sales of enhanced IP communications services through our direct consumer offering, iConnectHere. Enhanced IP communications services generated 60.2%, 54.8%, and 44.8% of our total revenues in 2002, 2001 and 2000,

respectively. The provision of enhanced IP communications services has not been profitable to date and may not be profitable in the future.

In the future, we intend to generate increased revenues from multiple sources, many of which are unproven, including the commercial sale of our Hosted Communications Solution and enhanced IP communications services. We expect that our revenues for the foreseeable future will be dependent on, among other factors:

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

We may not be able to sustain our current revenues or successfully generate additional revenues from the sale of enhanced IP communications services, Hosted Communications Solutions or carrier transmission services.

We Cannot Assure You That a Market for Our Services Will Develop

We are uncertain whether a market will develop for our enhanced IP communications services or our Hosted Communications Solutions. Our market is new and rapidly evolving. Our ability to sell our services may be inhibited by, among other factors, the reluctance of some end users to switch from traditional communications carriers to IP communications carriers and by concerns with the quality of IP telephony and the adequacy of security in the exchange of information over the Internet. End users in markets serviced by recently deregulated telecommunications providers are not familiar with obtaining services from competitors of these providers and may be reluctant to use new providers, such as us. Our ability to increase revenues depends on the migration of traditional telephone network traffic to our IP network. We will need to devote substantial resources to educate customers and end users about the benefits of IP communications solutions in general and our services in particular. If enterprises and their customers do not accept our enhanced IP communications services and our Hosted Communications Solutions as a means of sending and receiving communications, we will not be able to increase our number of paid users or successfully generate revenues in the future.

Our Future Success Depends on the Growth in the Use of the Internet as a Means of Communications

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

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

If Internet usage grows, the Internet infrastructure may not be able to support the demands placed on it by such growth, or its performance or reliability may decline. In addition, Web sites may from time to time experience interruptions in their service as a result of outages and other delays occurring throughout the Internet network

infrastructure. If these outages or delays frequently occur in the future, Internet usage, as well as usage of our communications portal and our services, could be adversely affected.

Potential Fluctuations in Our Quarterly Financial Results Make it Difficult for Investors to Predict Our Future Performance

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

- the rate at which we are able to attract users to purchase our enhanced IP communications services and our Hosted Communications Solutions;
- the amount and timing of expenses to enhance marketing and promotion efforts and to expand our infrastructure;
- the timing of announcements or introductions of new or enhanced services by us.

The factors outside our control include:

- the timing of announcements or introductions of new or enhanced services by our competitors;
- technical difficulties or network interruptions in the Internet or our privately-managed network;
- general economic and competitive conditions specific to our industry.

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

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

Our Network May Not Be Able to Accommodate Our Capacity Needs

We expect the volume of traffic we carry over our network to increase significantly as we expand our operations and service offerings. Our network may not be able to accommodate this additional volume. In order to ensure that we are able to handle additional traffic, we may have to enter into long-term agreements for leased capacity. To the extent that we overestimate our capacity needs, we may be obligated to pay for more transmission capacity than we actually use, resulting in costs without corresponding revenues. Conversely, if we underestimate our capacity needs, we may be required to obtain additional transmission capacity from more expensive sources. If we are unable to maintain sufficient capacity to meet the needs of our users, our reputation could be damaged and we could lose users.

We Face a Risk of Failure of Computer and Communications Systems Used in Our Business

Our business depends on the efficient and uninterrupted operation of our computer and communications systems as well as those that connect to our network. We maintain communications systems in four facilities in New York, Los Angeles, London and Jerusalem. Our systems and those that connect to our network are subject to disruption from natural disasters or other sources of power loss, communications failure, hardware or software malfunction, network failures and other events both within and beyond our control. Any system interruptions that cause our services to be unavailable, including significant or lengthy telephone network failures or difficulties for users in communicating through our network or portal, could damage our reputation and result in a loss of users.

Our Computer Systems and Operations May Be Vulnerable to Security Breaches

Our computer infrastructure is potentially vulnerable to physical or electronic computer viruses, break-ins and similar disruptive problems and security breaches that could cause interruptions, delays or loss of services to our users. We believe that the secure transmission of confidential information over the Internet, such as credit card numbers, is

essential in maintaining user confidence in our services. We rely on licensed encryption and authentication technology to effect secure transmission of confidential information, including credit card numbers. It is possible that advances in computer capabilities, new technologies or other developments could result in a compromise or breach of the technology we use to protect user transaction data. A party that is able to circumvent our security systems could misappropriate proprietary information or cause interruptions in our operations. Security breaches also could damage our reputation and expose us to a risk of loss or litigation and possible liability. Although we have experienced no security breaches to date of which we are aware, we cannot guarantee you that our security measures will prevent security breaches.

Third Parties Might Infringe Upon Our Proprietary Technology

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

Our Services May Infringe on the Intellectual Property Rights of Others

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

On October 8, 1999, we were named as a defendant in a lawsuit alleging that we are infringing on a patent by making, using, selling and offering for sale prepaid telephone card products in the United States. The plaintiffs are seeking an injunction to stop us from using the technology covered by this patent, monetary damages in an unspecified amount and reimbursement of attorneys' fees. We have answered the complaint, the parties engaged in pre-trial discovery, and the case remains at a preliminary stage. We believe that we have meritorious defenses to the claim and we intend to defend the lawsuit vigorously. However, the outcome of the litigation is inherently unpredictable and an unfavorable result may have a material adverse effect on our business, financial condition and results of operations. Regardless of the ultimate outcome, the litigation could result in substantial expenses to us and significant diversion of efforts by our managerial and other personnel.

Operating Internationally Exposes Us to Additional and Unpredictable Risks

We intend to continue to enter additional markets in Eastern Europe, Latin America, Africa and Asia and to expand our existing operations outside the United States. International operations are subject to inherent risks, including:

- potentially weaker protection of intellectual property rights;
- political instability;
- unexpected changes in regulations and tariffs;
- fluctuations in exchange rates;
- varying tax consequences;
- uncertain market acceptance and difficulties in marketing efforts due to language and cultural differences.

We Have Experienced Losses as a Result of Fraud

We have experienced losses due to fraud. In 2002, we experienced losses from fraud of less than 2% of our revenues. Callers have obtained our services without rendering payment by unlawfully using our access numbers and personal identification numbers. Although we have implemented anti-fraud measures in order to control losses relating to these practices, these measures may not be sufficient to effectively limit all of our exposure in the future from fraud and we continue to experience losses from fraud. While we have established reserves for bad debts in accordance with historical levels of uncollectible receivables resulting primarily from these fraudulent practices, our losses may exceed our reserves and could rise significantly above anticipated levels.

Intense Competition Could Reduce Our Market Share and Harm Our Financial Performance

Competition in the market for enhanced IP communications services is becoming increasingly intense and is expected to increase significantly in the future. The market for enhanced Internet and IP communications is new and rapidly evolving. We expect that competition from companies both in the Internet and telecommunications industries will increase in the future. Our competitors include both start-up IP telephony service providers and established traditional communications providers. Many of our existing competitors and potential competitors have broader portfolios of services, greater financial, management and operational resources, greater brand-name recognition, larger subscriber bases and more experience than we have. In addition, many of our IP telephony competitors use the Internet instead of a private network to transmit traffic. Operating and capital costs of these providers may be less than ours, potentially giving them a competitive advantage over us in terms of pricing.

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

If we are unable to provide competitive service offerings, we may lose existing users and be unable to attract additional users. In addition, many of our competitors, especially traditional carriers, enjoy economies of scale that result in a lower cost structure for transmission and related costs, which cause significant pricing pressures within the industry. Although the minutes of use we sell are increasing, revenues are not increasing at the same rate due primarily to a decrease in revenue per minute for our carrier transmission services. In order to remain competitive we intend to increase our efforts to promote our services, and we cannot be sure that we will be successful in doing this.

In addition to these competitive factors, recent and pending deregulation in some of our markets may encourage new entrants. We cannot assure you that additional competitors will not enter markets that we plan to serve or that we will be able to compete effectively.

Decreasing Telecommunications Rates May Diminish or Eliminate Our Competitive Pricing Advantage

Decreasing telecommunications rates may diminish or eliminate the competitive pricing advantage of our services. International and domestic telecommunications rates have decreased significantly over the last few years in most of the markets in which we operate, and we anticipate that rates will continue to be reduced in all of the markets in which we do business or expect to do business. Users who select our services to take advantage of the current pricing differential between traditional telecommunications rates and our rates may switch to traditional telecommunications carriers as such pricing differentials diminish or disappear, and we will be unable to use such pricing differentials to attract new customers in the future. In addition, our ability to market our carrier transmission services to telecommunications carriers depends upon the existence of spreads between the rates offered by us and the rates offered by traditional telecommunications carriers, as well as a spread between the retail and wholesale rates charged by the carriers from which we obtain wholesale service. Continued rate decreases will require us to lower our rates to remain competitive and will reduce or possibly eliminate our gross profit from our carrier transmission services. If telecommunications rates continue to decline, we may lose users for our services.

Government Regulation and Legal Uncertainties Relating to IP Telephony Could Harm Our Business

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

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

We May Not Be Able to Keep Pace with Rapid Technological Changes in the Communications Industry

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

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

Risks Related to Our Relationship with Atarey

Atarey Controls All Matters Submitted to a Stockholder Vote

Atarey owns approximately 72% of the voting power and economic interest in us. As long as Atarey continues to beneficially own shares of capital stock representing more than 50% of the voting power of our outstanding capital stock, Atarey will be able to exercise a controlling influence over decisions affecting us, including:

- composition of our board of directors and, through it, our direction and policies, including the appointment and removal of officers;
- mergers or other business combinations;
- acquisitions or dispositions of assets by us;
- future issuances of capital stock or other securities by us;
- incurrence of debt by us;

- amendments, waivers and modifications to any agreements between us and Atarey;
- payment of dividends on our capital stock;
- approval of our business plans and general business development.

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

Recently, Atarey made a proposal to purchase us. Although a special committee comprised of our independent directors is evaluating the proposal, as a practical matter, Atarey could, by virtue of its position as a 72% stockholder, cause us to go private without the assent of our directors and our minority stockholders and could block any other transaction.

Risks Related to Our Common Stock

A Third Party May Be Deterred from Acquiring Our Company

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

Volatility of Our Stock Price Could Adversely Affect Our Stockholders

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

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

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

Investors may not be able to resell their shares of our common stock following periods of volatility because of the market's adverse reaction to such volatility. In addition, the stock market in general, and the market for telecommunications, Internet-related and technology companies in particular, has been dramatically decreased and is extremely depressed.. We cannot assure you that our common stock will trade at the same levels of other telecommunications or Internet stocks or that telecommunications or Internet stocks in general will sustain their current market prices. We also cannot assure you that our common stock will continue to be quoted on the Nasdaq SmallCap Market if the price of our common stock remains below \$1.

The Liquidity of Our Common Stock Could Be Adversely Affected by Changes in Our Nasdaq Listing.

Our common stock is currently listed on the Nasdaq SmallCap Market. The listing of our common stock was transferred from the Nasdaq National Market to the Nasdaq SmallCap Market effective on September 17, 2002. We currently meet all criteria for continued inclusion in the Nasdaq SmallCap Market except for the \$1.00

minimum bid price per share requirement. We currently have a grace period until September 1, 2003 to demonstrate a closing bid price of at least \$1.00 for a minimum of ten consecutive trading days, provided we can demonstrate that we remain in compliance with the Nasdaq SmallCap Market's initial listing standards, based on the Nasdaq's most recent ruling. We have yet to satisfy this requirement, and if we do not do so prior to September 1, 2003, we may be delisted from the Nasdaq SmallCap Market on or about that date. If we are delisted from the Nasdaq SmallCap Market, our shares will continue to trade, if at all, on the OTC Bulletin Board, upon application by the requisite market makers. This will adversely impact our stock price, as well as the liquidity of the market for our shares which, as a result, will adversely affect the ability of our stockholders to purchase and sell their shares in an orderly manner, or at all. Furthermore, a delisting of our shares could damage our general business reputation and impair our ability to raise additional funds. Any of the foregoing events could have a material adverse effect on our business, financial condition and operating results.

We Do Not Intend to Pay Dividends

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Securities and Exchange Commission's rule related to market risk disclosure requires that we describe and quantify our potential losses from market risk sensitive instruments attributable to reasonably possible market changes. Market risk sensitive instruments include all financial or commodity instruments and other financial instruments (such as investments and debt) that are sensitive to future changes in interest rates, currency exchange rates, commodity prices or other market factors. We believe our exposure to market risk is immaterial. We currently do not invest in, or otherwise hold, for trading or other purposes, any financial instruments subject to market risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Company's Consolidated Financial Statements required by this Item are included in Item 14 of this report.

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The Board of Directors

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

Noam Bardin, 32 - Chairman of the Board. Mr. Bardin co-founded deltathree and has served as Chief Executive Officer and President from 2000 through June 17, 2002. Mr. Bardin has served as Chairman of the Board since April 2001. Mr. Bardin served as Vice President of Technology and Chief Technology Officer of deltathree since June 1997 before being named President and Chief Executive Officer in April 2000. He served as Global Network Director from November 1996 to May 1997. Prior to founding deltathree, he worked with Ambient Corporation. Mr. Bardin graduated from Hebrew University(Jerusalem) with a degree in Economics, and is currently attending the Harvard Kennedy School in pursuit of his Mid Career, Master of Public Administration degree.

Ehud Erez, 47 - Director. Mr. Erez has served as a director of deltathree since February 2002. Mr. Erez has served as the Chief Executive Officer of Atarey and President and Chief Financial Officer of El-Ad Group (Canada) since July 2001. Prior to July 2001, Mr. Erez was Auditor, Accountant and Partner of several accounting firms, including KPMG and Arthur Andersen. Prior to January 1985 Mr. Erez was a Revenue Inspector/Auditor for the Treasury Department in Jerusalem. Mr. Erez was an active member of the Auditing Standards Board of the Institute of Certified Public Accountants. He is a graduate of Hebrew University with a BA in Economics and Accounting and holds a CPA.

Amir Gera, 42 - Director. Mr. Gera has served as a director of deltathree since June 2001. Since January 2002, Mr. Gera has served as the Chief Executive Officer of Green Venture Capital Ltd., an investment holding company which engages primarily in acquiring holdings in venture capital funds, where he had previously served as the Assistant Director General since January 2001. In addition, Mr. Gera is also the Chief Executive Officer of Commutech Holding & Investments Ltd and has served in this capacity since March 2001. From 1993 through 2000, Mr. Gera was the Assistant Director General of Emet Neveh Savion Ltd., which owns and manages real estate assets.

Elie Housman, 66 - Director. Mr. Housman has served as a director of deltathree since August 2001. Since March 2001, Mr. Housman has served as the Chairman of InkSure, Inc. Prior to March 2001, Mr. Housman served as a Principal and Consultant to Charterhouse Group International, Inc., a private equity firm that manages approximately \$2 billion in assets. Prior to 1996, Mr. Housman was also the Chairman of Novo PLC, a media supply company in London, and President of Pioneer Commercial Funding Corporation. Prior to 1988, he founded UM Shipping Corporation, was Co-Owner of AP Parts Company, Chief Executive Officer of Rail Finance, Inc. and a Principal of Maritime Fruit Carriers Ltd., one of the world's largest diversified shipping companies. Mr. Housman is a graduate of the New School for Social Research with BA and MA degrees in Economics.

Joshua Maor, 67 - Director. Since January 2002, Mr. Maor has served as the Chairman of Green Venture Capital Ltd., an investment holding company which engages primarily in acquiring holdings in venture capital funds, and the Chairman of Commutech Holding & Investments Ltd., an investment holding company which engages primarily in investments in high tech companies. Mr. Maor served as both the Chairman and Chief Executive Officer Green Venture Capital Ltd from 1997 to January 2002. From 1996 through 1997, Mr. Maor was the Chairman of I.B.M. Israel

Ltd., which distributes and provides services for I.B.M. products, and I.B.M. Science and Technology Ltd., a research and development company. Mr. Maor served as a member of our Advisory Board from 1997 through 1998.

Lior Samuelson, 54 - Director. Mr. Samuelson has served as a director of deltathree since August 2001. Since August 1999, Mr. Samuelson has served as a Co-Founder and Principal of Mercator Capital. His experience includes advising clients in the Technology, Communications and Consumer sectors on mergers, acquisitions and private placements. From March 1997 to August 1999, Mr. Samuelson was the President and CEO of PricewaterhouseCoopers Securities. Prior to that, he was the President and CEO of The Barents Group, a merchant bank specializing in advising and investing in companies in emerging markets. Mr. Samuelson was also the Co-Chairman of Peloton Holdings, a Private Equity management company. Before that, he was a managing partner with KPMG and a senior consultant at Booz, Allen & Hamilton. Mr. Samuelson earned B.S. and M.S. degrees in Economics from Virginia Polytechnic University.

Shimmy Zimels, 37 - President and Chief Executive Officer and Director. Mr. Zimels has served as Chief Executive Officer and President since 2002, and served as Vice President of Operations and Chief Operating Officer of deltathree since June 1997, before being named President and Chief Executive Officer in June 2002. Prior to joining deltathree, Mr. Zimels was the Controller and Vice President of Finance at Net Media Ltd., a leading Israel-based Internet Service Provider, from June 1995 to June 1997. From April 1991 to May 1995, Mr. Zimels was a senior tax auditor for the Income Tax Bureau of the State of Israel. Mr. Zimels graduated with distinction from Hebrew University with a degree in Economics and Accounting and holds a Masters in Economics from Hebrew University.

Executive Officers

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

Paul C. White, 40 - Chief Financial Officer and Secretary. Mr. White has served as our Chief Financial Officer since September 2000 and is responsible for corporate finance and all financial aspects of our operations, including accounting, tax, treasury, financial analysis, billing, internal audit, investor relations, real estate and procurement functions. Mr. White brings a vast array of experience in both the telecommunications and Internet industries having served as President and Chief Executive Officer of TelecomRFQ, Inc., a business-to-business start-up designed to facilitate telecommunications procurement between business buyers and major suppliers. Mr. White cultivated his expertise in both telecommunications and the Internet with senior level positions at Buyersedge.com, where he served as Vice President of Operations & Finance, and at Southern New England Telecommunications (SNET), the SBC Communications, Inc. subsidiary, where he served as Director of IT Strategy & Finance, Director of Corporate Development and Director of Finance & Business Development between 1995 and 1999. Mr. White has also worked in senior level positions at Ernst & Young, LLP and Arthur Andersen, LLP. Mr. White has a BBA and an MBA from Hofstra University, as well as a CPA.

Board of Directors and Committees of the Board

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

The Board had five regular and no special meetings during the fiscal year ended December 31, 2002. During the fiscal year ended December 31, 2002, each member of the Board participated in at least 75% of all Board and applicable committee meetings held during the period for which he was a director. The Board has established an executive committee, a compensation committee and an audit committee to devote attention to specific subjects and

to assist the Board in the discharge of its responsibilities. The functions of these committees and their current members are set forth below.

The Executive Committee is empowered to act on any matter except those matters specifically reserved to the full Board by applicable law. The Executive Committee had no meetings during 2002. Amir Gera and Joshua Maor are the current members of the Executive Committee.

The Compensation Committee is responsible for evaluating our compensation policies, determining our executive compensation policies and guidelines and administering our stock option and compensation plans. The Compensation Committee had one meeting during 2002. Amir Gera and Joshua Maor are the current members of the Compensation Committee. Please see also the report of the Compensation Committee set forth elsewhere in this report.

We do not have a standing nominating committee.

The Audit Committee recommends to the Board the appointment of the firm selected to serve as our independent auditors and our subsidiaries and monitors the performance of such firm; reviews and approves the scope of the annual audit and evaluates with the independent auditors our annual audit and annual financial statements; reviews with management the status of internal accounting controls; evaluates issues having a potential financial impact on us which may be brought to the Audit Committee's attention by management, the independent auditors or the Board; evaluates our public financial reporting documents; reviews the non-audit services to be performed by the independent auditors, if any; and considers the effect of such performance on the auditor's independence. During the year ended December 31, 2002, the Board examined the composition of the Audit Committee in light of the adoption by The Nasdaq Stock Market of new rules governing audit committees. Based upon this examination, the Board confirmed that all members of the Audit Committee during the year ended December 31, 2002 were "independent" within the meaning of Nasdaq's new rules. The Audit Committee had five meetings during 2002. Ehud Erez, Elie Housman and Lior Samuelson are the current members of the Audit Committee. Under new listing rules adopted by the Securities and Exchange Commission in connection with the Sarbanes-Oxley Act of 2002, Mr. Erez will no longer meet the required criteria for audit committee member independence due to his position with Atarey, an affiliate of the Company. The SEC has stated that listed issuers will be required to comply with the new listing rules by the date of their first annual meeting of shareholders after January 15, 2004. The Company intends to replace Mr. Erez on the Audit Committee with a new member who meets the criteria for audit committee independence prior to such date.

Section 16(a) Beneficial Ownership Reporting Compliance

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

To our knowledge, based solely upon our review of the copies of such reports furnished to us, we believe that all of our directors, officers and greater than 10% stockholders have complied with the applicable Section 16(a) reporting requirements.

ITEM 11. EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth certain summary information concerning the compensation paid or awarded for services rendered during each of our last three fiscal years to our chief executive officer and each of our two other most

highly compensated executive officers in 2000, 2001 and 2002 whose total salary and bonus exceeded \$100,000. These three executive officers are referred to in this report as “named executive officers”.

Name and Principal Position	Year	Annual Compensation		Long-Term Compensation	
		Salary (\$)	Bonus (\$)	Securities Underlying Options (#)	All Other Compensation
Shimmy Zimels (1) President and Chief Executive Officer and former Chief Operating Officer.....	2002	182,335	—	100,000	—
	2001	214,395	—	80,000	—
	2000	187,500	112,000	130,000	—
Paul C. White Chief Financial Officer.....	2002	182,335	—	100,000	—
	2001	201,391	—	—	—
	2000	59,500	21,000	160,000	—
Noam Bardin (1) Chairman of the Board and Former President and Chief Executive Officer.....	2002	111,060	—	100,000	—
	2001	264,267	—	80,000	—
	2000	229,167	142,000	250,000	—

(1) Mr. Noam Bardin was our President and Chief Executive Officer until June 16, 2002. Mr. Shimmy Zimels, our former Chief Operating Officer, was appointed our Chief Executive Officer effective June 17, 2002.

Option Grants During 2002

The following table sets forth information regarding each stock option granted during fiscal year 2002 to each of the named executive officers.

Individual Grants

Name	Shares of Common Stock Underlying Options Granted (#)(1)	% of Total Options Granted to Employees in Fiscal Year	Exercise Price Per Share (\$/Sh)	Expiration Date	Potential Realizable Value at Assumed Rates of Stock Price Appreciation for Option Term (2)	
					5%	10%
Shimmy Zimels	100,000	7.45%	1.02	3/12/09	\$41,524	\$96,769
Paul C. White.....	100,000	7.45%	1.02	3/12/09	\$41,524	\$96,769
Noam Bardin.....	100,000	7.45%	1.02	3/12/09	\$41,524	\$96,769

(1) The options were granted pursuant to the Company’s 1999 Stock Incentive Plan (the “Plan”). The options granted to the named executive officers are non-qualified stock options and vest annually in three equal installments commencing one year from the date of grant.

(2) The amounts shown in this table represent hypothetical gains that could be achieved for the respective options if exercised at the end of the option term. These gains are based on assumed rates of stock appreciation of 5% and 10% compounded annually from the date the respective options were granted to their expiration date. The gains shown are net of the option exercise price, but do not include deductions for taxes or other expenses associated with the exercise. Actual gains, if any, on stock option exercises will depend on the future performance of the Common Stock, the optionee’s continued employment through the option period and the date on which the options are exercised.

Option Exercises in Fiscal 2002 and Year-End Option Values

The following table sets forth information for the named executive officers with respect to option exercises during 2002 and the value as of December 31, 2002 of unexercised in-the-money options held by each of the named executive officers.

Name	Shares Acquired On Exercise (#)	Value Realized (\$)	Number of Securities Underlying Unexercised Options at Year End (#) Exercisable /Unexercisable	Value of Unexercised In-The-Money Options at Year-End (\$) Exercisable/Unexercisable
Shimmy Zimels	—	—	383,938 /100,000	—
Paul C. White	—	—	160,000/100,000	—
Noam Bardin	—	—	503,938/100,000	—

Compensation Committee Interlocks and Insider Participation

Executive compensation decisions in 2002 were made by the Compensation Committee. During 2002, no interlocking relationship existed between our Board and the board of directors or compensation committee of any other company.

Director Compensation

During 2002, we paid \$10,000 to each of Lior Samuelson and Elie Housman for their services as directors, and paid \$5,000 to Noam Bardin for his services as a director for the one-half year term he served as a non-management director. We anticipate paying \$10,000 to each outside director in 2003.

Directors are reimbursed for the expenses they incur in attending meetings of the Board and Board committees. Under our 1999 Directors' Plan, each director who is not our employee receives options to purchase 24,848 shares of Common Stock on the date such director is elected to the Board. In addition, under our 1999 Directors' Plan, each non-employee director will be eligible to receive on an annual basis options to purchase 10,000 shares of Common Stock with an exercise price equal to the fair market value on the date of grant at the time of our Annual Meeting.

1999 Directors' Plan

The purposes of the 1999 Directors' Plan are to enable us to attract, maintain and motivate qualified directors and to enhance a long-term mutuality of interest between our directors and stockholders of our Common Stock by granting our directors options to purchase our shares.

Under the Directors' Plan, on the first business day following each annual meeting of our stockholders during the term of the Directors' Plan, each director who is not our employee will be granted options to acquire 10,000 shares of our Common Stock with an exercise price per share equal to the fair market value of a share of our Common Stock on the date of grant. These options will have a seven-year term and will become exercisable on the first anniversary of the date of grant. In addition, each director who was not our employee on the date of the completion of our initial public offering was granted options to acquire 24,848 shares of our Common Stock with an exercise price per share equal to the initial public offering price. Each individual who becomes a director will be granted options to acquire 24,848 shares of our Common Stock with an exercise price per share equal to the fair market value on the date of grant. These options will have a seven-year term and will be immediately exercisable. The maximum number of shares that may be issued under the Directors' Plan is 600,000 shares of Common Stock. The plan will terminate December 31, 2009, unless sooner terminated by our stockholders.

Employment Agreements

We currently have employment agreements in place with Messrs. White and Zimels, each with the following principal terms:

- The agreements, as amended, are effective until August 31, 2004, and shall thereafter automatically renew for one-year periods unless either party provides the other party with written notice of non-renewal at least 60 days prior to expiration of a term.
- Pursuant to the agreements, Mr. Zimels and Mr. White are entitled to receive a base salary of \$225,000 and \$213,000, respectively. Such base salary shall be increased on each January 1, commencing January 1, 2003, by an amount equal to his base salary then in effect, multiplied by the applicable cost of living index during the prior year. The employee's base salary, as adjusted for cost of living increases, may be further increased at the option and in the discretion of the Board.
- The employee's options are immediately exercisable in full upon a change of control. The employee's options, following any termination of the employee's employment, other than for cause, remain exercisable for the lesser of two years and the remaining term of his options.
- If employee's employment is terminated by us without cause or by the employee for good reason (which includes, without limitation, a reduction in salary and/or bonus opportunity, a change of control and a material reduction in duties and responsibilities), the employee is entitled to receive previously earned, but unpaid salary, vested benefits and a payment equal to his base salary as in effect immediately prior to the termination date.
- If employee dies or is unable to perform his duties, he or his representative, estate or beneficiary will be paid, in addition to any previously earned but unpaid salary and vested benefits, 12 months' total base salary reduced, in the case of disability, by any disability benefits he receives.

On March 31, 2002, the employment agreements for each of Mr. Bardin and Mr. Zimels expired pursuant to the terms of the original employment agreements. Messrs. Bardin's, and Zimels' employment agreements were extended until September 30, 2002 on the same terms as their original employment agreements. At the same time, Messrs. Bardin, White and Zimels each took a voluntary pay reduction for an unspecified time, from their then current salaries of \$266,513, \$213,210, and \$213,210, respectively, to \$180,000 each. On June 16, 2002, Mr. Bardin's employment agreement ceased to be in effect due to his resignation as Chief Executive Officer. On September 1, 2002, the employment agreements for Mr. Zimels and Mr. White were extended until August 31, 2004. Messrs. Zimels' and White's have kept their voluntary pay reduction in effect at \$180,000 each whereas their current contractual salaries have increased to \$232,650 and \$220,242, respectively, due to a cost-of-living increase clause included in their respective contracts.

Compensation Committee Report on Executive Compensation

The Compensation Committee is responsible for recommending to the Board of Directors the overall executive compensation strategy of the Company and for the ongoing monitoring of the compensation strategy's implementation. In addition to recommending and reviewing the compensation of the executive officers, it is the responsibility of the Compensation Committee to recommend new incentive compensation plans and to implement changes and improvements to existing compensation plans, including the 1999 Stock Incentive Plan, the 1999 Performance Incentive Plan, the 1999 Employee Stock Purchase Plan and the 1999 Directors' Plan. The Compensation Committee makes its compensation determinations based upon its own analysis of information it compiles and the business experience of its members.

Overall Policy

Compensation Committee believes that the stability of the Company's management team, as well as the Company's ability to continue to incentivize management and to attract and retain highly qualified executives for its expanding operations, will be a contributing factor to the Company's continued growth and success. In order to promote stability, growth and performance, and to attract new executives, the Company's strategy is to compensate its executives with an overall package that the Company believes is competitive with those offered by similarly situated companies and which consists of (i) a stable base salary set at a sufficiently high level to retain and motivate these

officers but generally targeted to be in the lower half of its peer group comparables, (ii) an annual bonus linked to the Company's overall performance each year and to the individual executive's performance each year and (iii) equity-related compensation which aligns the financial interests of the Company's executive officers with those of the Company's stockholders by promoting stock ownership and stock performance through the grant of stock options and stock appreciation rights, restricted stock and other equity and equity-based interests under the Company's various plans.

Executive officers are also entitled to customary benefits generally available to all employees of the Company, including group medical and life insurance. Base salary, bonuses and benefits are paid by the Company and its subsidiaries.

Federal Income Tax Deductibility of Executive Compensation

Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), limits the amount of compensation a publicly held corporation may deduct as a business expense for Federal income tax purposes. The limit, which applies to a company's chief executive officer and the four other most highly compensated executive officers, is \$1 million (the "Deductibility Limit"), subject to certain exceptions. The exceptions include the general exclusion of performance-based compensation from the calculation of an executive officer's compensation for purposes of determining whether his or her compensation exceeds the Deductibility Limit. The Compensation Committee has determined that compensation payable to the executive officers should generally meet the conditions required for full deductibility under section 162(m) of the Code. While the Company does not expect to pay its executive officers compensation in excess of the Deductibility Limit, the Compensation Committee also recognizes that in certain instances it may be in the best interest of the Company to provide compensation that is not fully deductible.

With respect to the 1999 Performance Incentive Plan described below, because the 1999 Performance Incentive Plan was in existence prior to the completion of the Company's initial public offering, the Deductibility Limit generally will not apply to payments under such plan until the Company's annual general meeting of stockholders to be held in 2001, the first meeting of the Company's stockholders at which directors will be elected after the close of the third calendar year following the calendar year in which the initial public offering was closed.

Base Salary

The base salaries for the named executive officers are based upon employment agreements between the Company and such officers.

Annual Incentive Bonuses

The Board of Directors approved the 1999 Performance Incentive Plan established by RSL COM. The Company established the Performance Incentive Plan to enable the Company and its subsidiaries to attract, retain, motivate and reward the best qualified executive officers and key employees by providing them with the opportunity to earn competitive compensation directly linked to the Company's performance. The Performance Incentive Plan is effective through and including the year 2005, unless extended or earlier terminated by the Board of Directors. As part of the Performance Incentive Plan, the Compensation Committee may determine that any bonus payable under the Performance Incentive Plan be paid in cash, in shares of Common Stock or in any combination thereof, provided that at least 50% of such bonus is required to be paid in cash. In addition, the Performance Incentive Plan permits a participant to elect to defer payment of his or her bonus on terms and conditions established by the Compensation Committee. No more than 400,000 shares of Common Stock may be issued under the Performance Incentive Plan.

Under the 1999 Performance Incentive Plan, bonuses may be payable if the Company meets any one or more of the following performance criteria, which are set annually by the Compensation Committee: (i) revenues; (ii) operating income; (iii) gross profit margin; (iv) net income; (v) earnings per share; (vi) maximum capital or marketing expenditures; or (vii) targeted levels of customers.

Under the 1999 Performance Incentive Plan, bonus amounts are determined as follows: if 100% of such targets are achieved, the bonus potentially payable to participants will generally equal 35% of their base salary for such year, if 80% of such targets are achieved, the bonus potentially payable to participants will generally equal 25% of their base salary for such year, and if less than 80% of such targets are achieved, the participants will generally not be entitled to receive any bonus for such year. To the extent the Company's results exceed 80% of the targets but is less than 100% of the targets, the amount of the bonus payable to participants will be adjusted proportionately based on where such results fall within the ranges set forth above. Any such bonus will consist of two components. Fifty percent of the amount determined pursuant to the formula described above will be payable if the targets are achieved. Up to an additional 50% of such amount will be payable in the discretion of the Compensation Committee. In addition, the 1999 Performance Incentive Plan permits the Compensation Committee to grant discretionary bonuses to participants, notwithstanding that a bonus would not otherwise be payable under the 1999 Performance Incentive Plan, to recognize extraordinary individual performance.

With respect to 2002, there were no bonuses awarded to any executive officer. Pursuant to the terms of the 1999 Performance Incentive Plan, any awards would have been paid in the current year, promptly following the completion of the audit of the Company's 2002 financial statements.

Long-Term Incentive Compensation

The Company reinforces the importance of producing satisfactory returns to stockholders over the long term through the operation of the 1999 Stock Incentive Plan and the 1999 Directors' Plan. For a discussion relating to the 1999 Directors' Plan, refer to the section entitled "1999 Directors' Plan" in this annual report. Grants of stock, stock options, stock unit awards and stock appreciation rights under such plans provide executives with the opportunity to acquire an equity interest in the Company and align the executive's interest with that of the stockholders to create stockholder value as reflected in growth in the market price of the Common Stock.

1999 Stock Incentive Plan

The Board of Directors adopted the 1999 Stock Incentive Plan in conjunction with the Company's initial public offering. The purposes of the 1999 Stock Incentive Plan are to foster and promote the long-term financial success of the Company and materially increase stockholder value by (i) motivating superior performance by means of performance-related incentives, (ii) encouraging and providing for the acquisition of an ownership interest in the Company by executive officers and other key employees and (iii) enabling the Company to attract and retain the services of an outstanding management team upon whose judgment, interest and special effort the successful conduct of its operations is largely dependent.

Under the 1999 Stock Incentive Plan, the Compensation Committee is authorized to grant options for up to 4,000,000 shares of Common Stock. This represented, upon completion of the initial public offering, approximately 15% of the outstanding shares of the Company, on a fully diluted basis. Options granted under the 1999 Stock Incentive Plan are to be granted to certain officers of the Company and to other employees and consultants of the Company. Directors who are non-employees of the Company are prohibited from participating in the 1999 Stock Incentive Plan.

The 1999 Stock Incentive Plan is administered by the Compensation Committee and provides for the grant of (i) incentive and non-incentive stock options to purchase Common Stock; (ii) stock appreciation rights, which may be granted in tandem with or independently of stock options; (iii) restricted stock and restricted units; (iv) incentive stock and incentive units; (v) deferred stock units; and (vi) stock in lieu of cash. The maximum number of shares for which options or stock appreciation rights may be granted to any one participant in a calendar year is 600,000. As of December 31, 2002, the Company has granted options to acquire an aggregate of 2,591,205 shares of Common Stock.

Chief Executive Officer's Fiscal 2002 Compensation

Mr. Noam Bardin was our chief executive officer until June 17, 2002. Under the terms of his employment agreement, Mr. Bardin was entitled to receive an aggregate annual base salary of \$266,513. However, during 2002, Mr. Bardin received an aggregate of \$111,060, which did not include any bonus compensation, due to his voluntary pay reduction and subsequent resignation in June 2002. Mr. Shimmy Zimels, who became our chief executive officer effective June 17, 2002, is entitled to an annual base salary of \$232,650 pursuant to the terms of his employment agreement. During 2002, Mr. Zimels received an aggregate of \$182,335, which did not include any bonus compensation, due to his voluntary pay reduction.

Submitted by:

The Compensation Committee
Amir Gera
Joshua Maor

ITEM 12. SECURITY OWNERSHIP OF MANAGEMENT AND PRINCIPAL STOCKHOLDERS

The following table sets forth information with respect to the beneficial ownership of shares of our Common Stock as of April 29, 2003 by:

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

Unless otherwise indicated, to our knowledge, all persons listed below have sole voting and investment power with respect to their shares of Common Stock. Each person listed below disclaims beneficial ownership of their shares, except to the extent of their pecuniary interests therein. Shares of Common Stock that an individual or group has the right to acquire within 60 days of April 21, 2003 pursuant to the exercise of options are deemed to be outstanding for the purpose of computing the percentage ownership of such person or group, but are not deemed outstanding for the purpose of calculating the percentage owned by any other person listed.

	<u>Number of Shares</u>	<u>Percentage(1)</u>
	<u>of deltathree Class A Common Stock Beneficially Owned</u>	
Principal Stockholder:		
Atarey Hasharon Chevra Lepituach Vehashkaot Benadlan (1991) Ltd. 7 Giborey Israel St., P.O. Box 8468. South Netanya Industrial Zone 42504, Israel.	20,655,402	70.8%
Executive Officers and Directors:		
Noam Bardin(2)(3).....	791,304	2.7%
Shimmy Zimels(2)(4).....	548,407	1.9%
Paul C. White(2)(5).....	260,000	*
Ehud Erez (2)(5)(6).....	24,848	*
Amir Gera (2)(5).....	24,848	*
Elie Housman (2)(5).....	24,848	*
Joshua Maor (2)(7).....	40,999	*
Lior Samuelson (2)(5).....	24,848	*
All Directors and Executive Officers as a group (8 persons)(8).....	1,740,102	6.0%

* Less than 1%.

- (1) Percentage of beneficial ownership is based on 29,143,206 shares of Common Stock outstanding as of April 11, 2003.
- (2) The address for the director or executive officer listed is c/o the Company.
- (3) Includes (a) 187,366 shares of Common Stock and (b) options to purchase 603,938 shares of Common Stock.
- (4) Includes (a) 64,469 shares of Common Stock and (b) options to purchase 483,938 shares of Common Stock.
- (5) Represents options to purchase shares of Common Stock.
- (6) Excludes the 20,655,402 shares of Common Stock owned by Atarey.
- (7) Includes (a) 16,151 shares of Common Stock and (b) options to purchase 24,848 shares of Common Stock.
- (8) Includes options to purchase 1,472,116 shares of Common Stock.

Equity Compensation Plan Information

The following table provides certain aggregate information with respect to all of our equity compensation plans in effect as of December 31, 2002:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in first column)
Equity Compensation Plans Approved by Security Holders (1)	3,449,520	\$2.87	550,480
Equity Compensation Plans not Approved by Security Holders	N/A	N/A	N/A
Total	3,449,520	\$2.87	550,480

(1) These plans consist of our 1999 Stock Incentive Plan, 1999 Directors' Plan, and 1999 Employee Stock Purchase Plan.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

We believe that all of the transactions described below were made on an arms-length basis. All future transactions between us and our officers, directors, principal stockholders and affiliates must be approved, in good faith, by a majority of the Board, including a majority of the disinterested directors, unless they are on terms no less favorable to us than could be obtained from unaffiliated third parties.

On February 6, 2003, we announced that we had received a letter from D3 Acquisition, Inc. relating to a proposal to purchase all of our outstanding shares not held by Atarey Hasharon Chevra Lepituach Vehashkaot Benadlan (1991) Ltd. ("Atarey") and its affiliates for a price of \$0.70 per share in cash by means of a cash tender offer. The proposal contemplates that upon successful completion of the tender offer, D3 Acquisition would merge into us and we would survive and continue as a wholly owned private subsidiary of Atarey. D3 Acquisition is a wholly owned special purpose acquisition corporation formed by Atarey. Together, Atarey and its affiliates currently own approximately 71% (20,655,402 shares) of our outstanding common stock. Our board of directors has formed a special committee comprised of independent directors to evaluate the proposal and negotiate its terms. Ehud Erez, a member of our Board of Directors, is currently the Chief Executive Officer of Atarey.

ITEM 14. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures.* Our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15d-14(c)) as of a date within 90 days of the filing date of this annual report on Form 10-K, have concluded that, based on such evaluation, our disclosure controls and procedures were adequate and effective to ensure that material information relating to us, including our consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this annual report on Form 10-K was being prepared.

(b) *Changes in Internal Controls.* There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, nor were there any significant deficiencies or material weaknesses in our internal controls. Accordingly, no corrective actions were required or undertaken.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a)(1) Financial Statements.

The Consolidated Financial Statements filed as part of this Annual Report on Form 10-K are identified in the Index to Consolidated Financial Statements on page F-1 hereto.

(a)(2) Financial Statement Schedules.

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

(a)(3) Exhibits.

The following exhibits are filed herewith or are incorporated by reference to exhibits previously filed with the Securities and Exchange Commission.

<u>Exhibit Number</u>	<u>Description</u>
3.1.1*	Form of Restated Certificate of Incorporation of deltathree, Inc.
3.1.2***	Form of Amendment to Restated Certificate of Incorporation of deltathree, Inc.
3.2*	Form of Amended and Restated By-laws of deltathree, Inc.
4.1*	Specimen Certificate of Common Stock.
4.2*	Specimen Certificate of Class B Common Stock.
10.1*	Form of deltathree, Inc. 1999 Stock Incentive Plan.
10.2*	Form of deltathree, Inc. 1999 Employee Stock Purchase Plan.
10.3*	Form of deltathree, Inc. 1999 Performance Incentive Plan.
10.4*	Form of deltathree, Inc. 1999 Directors' Plan.
10.5*	Employment Agreement, effective as of April 1, 1999, between Noam Bardin and deltathree, Inc.
10.6**	Amendment No. 1 to Employment Agreement, effective as of June 1, 2000, between Noam Bardin and deltathree, Inc.
10.7*	Employment Agreement, effective as of April 1, 1999, between Shimmy Zimels and deltathree, Inc.
10.8**	Amendment No. 1 to Employment Agreement, effective as of June 1, 2000, between Shimmy Zimels and deltathree, Inc.
10.9**	Employment Agreement, effective as of August 28, 2000, between Paul White and deltathree, Inc.
10.10#	Amendment No. 2 to Employment Agreement, effective as of March 25, 2002, between Shimmy Zimels and deltathree, Inc.
10.11#	Amendment No. 3 to Employment Agreement, effective as of September 1, 2002, between Shimmy Zimels and deltathree, Inc.
10.12#	Amendment No. 1 to Employment Agreement, effective as of September 1, 2002, between Paul C. White and deltathree, Inc.
23.1##	Consent of Brightman Almagor & Co.
99.1##	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

* Incorporated by reference to the Company's registration statement on Form S-1 (Registration No. 333-86503).

** Incorporated by reference to the Company's quarterly report on Form 10-Q filed on November 14, 2000.

*** Incorporated by reference to the Company's annual report on Form 10-K/A filed on April 30, 2001.

Incorporated by reference to the Company's quarterly report on Form 10-Q filed on November 14, 2002.

Incorporated by reference to the Company's annual report on Form 10-K filed on March 31, 2003.

(b) Reports on Form 8-K: None.

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
DELTATHREE, INC.**

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INDEPENDENT AUDITORS' REPORT

To the Stockholders of
Deltathree, Inc.

We have audited the accompanying consolidated balance sheets of Deltathree, Inc. ("the Company") as of December 31, 2002 and 2001 and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2002 and 2001, and the consolidated results of its operations and consolidated cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

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

Tel Aviv, Israel
March 10, 2003

**DELTATHREE, INC.
CONSOLIDATED BALANCE SHEETS**

	December 31,	
	<u>2002</u>	<u>2001</u>
	(\$ in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 5,681	\$ 13,583
Short-term investments	15,552	14,192
Accounts receivable, net (Note 3)	652	1,092
Prepaid expenses and other current assets (Note 4).....	760	1,264
Total current assets.....	22,645	30,131
Property and equipment:		
Telecommunications equipment	14,344	14,068
Furniture, fixtures and other.....	570	591
Leasehold improvements.....	4,615	4,631
Computers hardware & software	6,891	6,751
	26,420	26,041
Less accumulated depreciation	(16,968)	(10,406)
Property and equipment, net	9,452	15,635
Deposits	100	103
Total assets.....	\$ 32,197	\$ 45,869
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current liabilities:		
Accounts payable	\$ 2,306	\$ 3,417
Deferred revenues	334	505
Other current liabilities (Note 5)	2,330	2,835
Total current liabilities	4,970	6,757
Long-term liabilities:		
Severance pay obligations (Note 6)	113	191
Total liabilities.....	5,083	6,948
Commitments and contingencies (Note 7)		
Stockholder's equity: (Note 8)		
Share capital:		
Class A Common stock, - par value \$0.001; authorized 75,000,000 shares; issued and outstanding: 29,159,772 at December 31, 2002; 29,143,206 at December 31, 2001		
	29	29
Class B Common stock - par value \$0.001; authorized 1,000; issued and outstanding: no shares at December 31, 2002; 19,569,459 at December 31, 2000		
	-	-
Preferred stock, par value \$0.001; authorized 25,000,000 shares; issued and outstanding: no shares at December 31, 2002 and 2001		
	-	-
Additional paid-in capital.....	166,801	166,801
Deferred stock based compensation.....	-	(270)
Accumulated deficit	(139,506)	(127,429)
Treasury stock at cost: 257,600 shares of Class A Common Stock as of December 31, 2002 and 2001	(210)	(210)
Total stockholder's equity.....	27,114	38,921
Total liabilities and stockholder's equity.....	\$ 32,197	\$ 45,869

The accompanying notes are an integral part of these financial statements

DELTATHREE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 31,		
	2002	2001	2000
	(\$ in thousands, except share data)		
Revenues: (Note 13)			
Affiliates.....	\$ -	\$ 1,669	\$ 13,977
Non-affiliates.....	12,929	13,991	16,399
Total revenues.....	12,929	15,660	30,376
Costs and operating expenses:			
Cost of revenues, net.....	8,934	13,486	24,932
Research and development expenses, net (Note 9)	3,435	5,648	6,625
Selling and marketing expenses.....	3,910	7,800	20,548
General and administrative expenses (exclusive of non-cash compensation expense shown below)	2,158	6,982	6,694
Non-cash compensation expense.....	270	825	6,331
Depreciation and amortization	6,606	8,996	7,919
Write-down of fixed assets (Note 10).....	-	1,003	-
Expenses due to cancellation of agreement with a supplier (including non-cash compensation of \$1,493) (Note 8b).....	-	3,628	-
Impairment of goodwill (Note 13).....	-	4,151	8,905
Total costs and operating expenses	25,313	52,519	81,954
Loss from operations.....	(12,384)	(36,859)	(51,578)
Interest income (expense), net	448	1,677	3,632
Loss before income taxes.....	(11,936)	(35,182)	(47,946)
Income taxes (Note 12).....	141	552	311
Net loss.....	\$ (12,077)	\$ (35,734)	\$ (48,257)
Net loss per share - basic and diluted	\$ (0.42)	\$ (1.23)	\$ (1.67)
Weighted average number of shares outstanding - basic and diluted (number of shares).....	28,888,367	29,035,319	28,832,708

The accompanying notes are an integral part of these financial statements

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

	<u>Class A Common stock</u>		<u>Class B Common stock</u>		<u>Additional paid-in capital</u>	<u>Receivable for capital Deficit</u>	<u>Deferred compensation</u>	<u>Treasury stock (at cost)</u>	<u>Accumulated deficit</u>	<u>Total Stockholders' Equity (deficiency)</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>						
Balance at January 1, 2000.....	8,918,132	\$ 9	19,569,459	\$20	157,891	\$ (1,232)	(10,670)	\$ -	\$ (43,438)	\$ 102,580
Issuance of common stock in purchase of subsidiary.....	227,738				10,500					10,500
Issuance expenses					(272)					(272)
Cancellation of options					(2,751)		2,751			-
Exercise of employee options....	319,229				1,365	232				1,597
Offset of receivable against debt to Yahoo! for services rendered						1,000				1,000
Amortization of deferred compensation expense							5,331			5,331
Loss for the year.....									(48,257)	(48,257)
Balance at December 31, 2000..	9,465,099	9	19,569,459	20	166,733	-	(2,588)	-	(91,695)	72,479
Exercise of employee options....	108,648				68					
Purchase of treasury stock	(257,600)							(210)		(210)
Cancellation of class B shares ...	19,569,459	20	(19,569,459)	(20)						
Amortization of deferred compensation expense							2,318			2,318
Loss for the year.....									(35,734)	(35,734)
Balance at December 31, 2001..	28,885,606	29	-	-	166,801	-	(270)	(210)	(127,429)	38,921
Exercise of employee options....	16,566	-*			-					-
Amortization of deferred compensation expense							270			270
Loss for the year.....									(12,077)	(12,077)
Balance at December 31, 2002..	28,902,172	\$ 29	-	\$ -	\$ 166,801	\$ -	\$ (270)	\$ (210)	\$ (139,506)	\$ 27,144

* - Less than \$ 1 thousand.

The accompanying notes are an integral part of these financial statements

DELTATHREE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	<u>Year ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(\$ in thousands)		
Cash flows from operating activities:			
Net loss.....	\$ (12,077)	\$ (35,734)	\$ (48,257)
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation and amortization.....	6,606	8,996	7,919
Write-down of fixed assets	-	1,003	-
Impairment of goodwill	-	4,151	8,905
Amortization of deferred compensation	270	2,318	6,331
Capital loss (gain), net	(56)	1	11
Increase (decrease) in liability for severance pay, net.....	(78)	22	(39)
Provision for losses on accounts receivable	81	1,104	199
Changes in assets and liabilities:			
Decrease (increase) in accounts receivable	359	1,272	(2,541)
Decrease (increase) in other current assets and due from affiliates	504	928	(168)
Increase (decrease) in accounts payable.....	(975)	(3,053)	2,656
Increase (decrease) in deferred revenues.....	(171)	254	(287)
Increase in current liabilities and due to affiliates	(667)	(3,965)	1,860
	<u>5,873</u>	<u>13,028</u>	<u>24,846</u>
Net cash used in operating activities.....	<u>(6,204)</u>	<u>(22,703)</u>	<u>(23,411)</u>
Cash flows from investing activities:			
Purchase of property and equipment	(403)	(1,558)	(13,585)
Proceeds from sale of property and equipment	62	467	54
Proceeds from sale of investment	-	-	150
Increase (decrease) in deposits	3	(30)	385
Net cash used in investing activities	<u>(338)</u>	<u>(1,121)</u>	<u>(12,996)</u>
Cash flows from financing activities:			
Decrease (increase) in short-term investments	(1,360)	16,692	(19,266)
Repayment of short term debt from affiliates.....	-	-	(14,752)
Expenses relating to share issuance in 1999.....	-	-	(272)
Purchase of treasury stock	-	(210)	-
Proceeds from exercise of employee options	-	68	1,597
Net cash provided by (used in) financing activities.....	<u>(1,360)</u>	<u>16,550</u>	<u>(32,693)</u>
Increase (decrease) in cash and cash equivalents	(7,902)	(7,274)	(69,100)
Cash and cash equivalents at beginning of year	13,583	20,857	89,957
Cash and cash equivalents at end of year	<u>\$ 5,681</u>	<u>\$ 13,583</u>	<u>\$ 20,857</u>
Supplemental disclosures of cash flow information:			
Cash paid for:			
Interest.....	\$ -	\$ -	\$ 1,332
Taxes	\$ 236	\$ 552	\$ 311
Supplemental schedule of non cash investing and financing activities:			
Acquisition of fixed assets on credit	\$ 194	\$ -	\$ -
Assets purchased in exchange for a receivable	\$ -	\$ -	\$ 2,500
Assets purchased in exchange for shares (See Note 13)	\$ -	\$ -	\$ 10,500

The accompanying notes are an integral part of these financial statements

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - The Company

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

Prior to 1999, the Company's business primarily consisted of carrying and transmitting traffic for communications carriers over its network. Beginning in 1999, the Company began to diversify its offering by layering enhanced IP telephony services over its privately managed network. These enhanced services were targeted at consumers and were primarily accessible through a consumer-oriented Web site. During 2000, the Company 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.

The Company's headquarters are located in New York City, New York. The Company's research and development activities are conducted in Israel by its wholly owned subsidiary, Delta Three Israel Ltd. ("Delta Ltd.").

Prior to its November 1999 initial public offering, the Company was a wholly owned subsidiary of RSL Communications Ltd, a multinational telecommunications company. RSL Communications Ltd. and its subsidiaries and affiliates (excluding the Company) are collectively referred to herein as "RSL COM" or "affiliates." Approximately 0%, 11% and 46 % of the Company's revenues for the year ended December 31, 2002, 2001 and 2000, respectively, were derived from transactions with RSL COM.

Since the Company's initial public offering in November 1999, RSL COM owned 100% of the outstanding Class B common stock (which carried ten votes per share), which represented approximately 95.5% of the combined voting power of all the Company's outstanding capital stock and approximately 67.4% of the economic interest in the Company. In March 2001, RSL COM commenced insolvency proceedings in Bermuda. On June 28, 2001, RSL COM, entered into a share purchase agreement with Atarey Hasharon Chevra Lepituach Vehashkaot Benadlan (1991) Ltd., an Israeli company ("Atarey") to sell to Atarey all of the Class B Common Stock of the Company owned by RSL COM. On June 29, 2001, the sale was consummated, and all of RSL COM's shares of Class B Common Stock, were automatically converted into shares of Class A Common Stock, which carry one vote per share. As a result of the sales transaction, Atarey became the majority stockholder of the Company, owning approximately 72% of the outstanding Class A Common Stock of the Company. Simultaneously with the completion of the transaction on June 29, 2001, all of the contracts and inter-company agreements by and between RSL COM (and all of its subsidiaries) and the Company were terminated. At the same time, the Company severed its reliance on RSL COM as its primary pan-European wholesale telecommunications carrier, and shifted to other service providers.

Note 2 - Summary of significant accounting policies

a. Principles of consolidation and basis of presentation

The consolidated financial statements include the accounts of Deltathree, Inc. and its subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

b. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions, primarily for allowances for doubtful accounts receivable and the useful lives of fixed assets and intangible assets, that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

c. Cash and cash equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (Cont.)

d. Revenue recognition and deferred revenue

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

e. Cost of revenues

Cost of revenues is comprised primarily of access, transmission and termination costs based on actual minutes in addition to monthly circuit lease costs and is net of reimbursements from vendors.

f. Research and development expenses

Research and development expenses, net of reimbursements from vendors, are expensed as incurred.

g. Advertising expenses

Advertising expenses are expensed as incurred. For the years ended December 31, 2002, 2001 and 2000, advertising expenses were approximately \$ 20,000, \$ 7,000 and \$ 170,000, respectively.

h. Allowance for doubtful accounts

The Company estimates the allowance for doubtful accounts by reviewing the status of significant past due receivables and analyzing historical bad debt trends and the Company then reduces accounts receivables by such allowance for doubtful accounts to expected net realizable value.

i. Property and equipment and related depreciation

Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the depreciable assets, which range from two to five years. Improvements are capitalized, while repair and maintenance costs are charged to operations as incurred.

j. Impairment of long-lived assets

On January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," (SFAS 144) which requires that long-lived assets, to be held and used by an entity, be reviewed for impairment and, if necessary, written down to the estimated fair values, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through undiscounted future cash flows. The adoption of SFAS 144 did not have a material effect on the Company's consolidated financial position or results of operations.

k. Income taxes

The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes". SFAS No. 109 establishes financial accounting and reporting standards for the effect of income taxes that result from activities during the current and preceding years. SFAS No. 109 requires an asset and liability approach for financial reporting for income taxes. The Company's foreign subsidiary files separate income tax returns in the jurisdiction of their operations.

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (Cont.)

l. Net loss per share

Basic and diluted net loss per share have been computed in accordance with SFAS No. 128, "Earnings Per Share", using the weighted average number of common stock outstanding. Diluted earnings per share give effect to all potential dilutive issuances of ordinary shares that were outstanding during the period. A total of 32,746; 168,212; and, 832,600 incremental shares were excluded from the calculation of diluted net loss per ordinary share for 2002, 2001 and 2000 respectively.

m. Concentration of credit risk

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

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

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

n. Fair value of financial instruments

The carrying amounts of cash and cash equivalents, accounts and other receivables and accounts payable approximate fair value due to the short-term maturity of these instruments. The carrying amounts of outstanding borrowings approximate fair value due to their short-term interest rate.

o. Derivatives

The Company adopted Statement of Financial Accounting Standard (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, at the beginning of fiscal year 2001. The standard requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through the statement of operations. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings, or recognized in other comprehensive income (loss) until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company use of derivatives is immaterial.

p. Effects of recently issued accounting standards

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements SFAS Nos. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections." SFAS No. 145 will impact how companies account for sale-leaseback transactions and how gains or losses on debt extinguishments are presented in financial statements. SFAS No. 145 is effective for fiscal years beginning after May 15, 2002, early application is encouraged. The application of the requirements of SFAS No. 145 will not have a material impact on the Company's financial position or results of operations.

In July 2002, the FASB issued SFAS No.146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires that a liability for costs associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The application of the requirements of SFAS No. 146 will not have a material impact on the Company's financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", which clarifies disclosure and recognition/measurement requirements related to certain guarantees. The disclosure requirements are effective for financial statements issued after December 15, 2002 and the recognition/measurement requirements are effective on a prospective basis for guarantees issued or modified after December 31, 2002. The application of the requirements of FIN 45 will not have a material impact on the Company's financial position or results of operations.

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Summary of significant accounting policies (Cont.)

r. Effects of recently issued accounting standards (Cont.)

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock Based Compensation—Transition and Disclosure—as Amendment to FAS 123." SFAS 148 provides two additional transition methods for entities that adopt the preferable method of accounting for stock based compensation. Further, the statement requires disclosure of comparable information for all companies regardless of whether, when, or how an entity adopts the preferable, fair value based method of accounting. These disclosures are now required for interim periods in addition to the traditional annual disclosure. The amendments to SFAS No. 123, which provides for additional transition methods, are effective for periods beginning after December 15, 2002, although earlier application is permitted. The amendments to the disclosure requirements are required for financial reports containing condensed financial statements for interim periods beginning after December 15, 2002.

q. Stock-based compensation

The Company accounts for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and in accordance with FASB Interpretation No. 44. Pursuant to these accounting pronouncements, the Group records compensation for stock options granted to employees over the vesting period of the options based on the difference, if any, between the exercise price of the options and the market price of the underlying shares at that date. Deferred compensation is amortized to compensation expense over the vesting period of the options. See below a pro forma disclosure required in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation", as amended by SFAS No. 148.

If compensation cost for the Company's stock options and restricted units had been determined based on fair value at the grant date in accordance with SFAS No. 123 provisions as amended by SFAS No. 148, the Company's pro forma net loss and pro forma basic and diluted net loss per share would have been as follows:

	December 31,		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<u>(\$ in thousands)</u>		
Pro forma net loss:			
Net loss for the year, as reported	\$ (12,077)	\$ (35,734)	\$ (48,257)
Deduct: stock-based compensation determined under APB 25 ..	270	825	6,331
Add: stock-based compensation determined under SFAS 123 ...	<u>(2,102)</u>	<u>(3,434)</u>	<u>7,569</u>
Pro forma net loss	<u>\$ (13,909)</u>	<u>\$ (38,343)</u>	<u>\$ (34,357)</u>
Net loss per share - basic and diluted:			
As reported.....	\$ (0.42)	\$ (1.23)	\$ (1.67)
Pro forma	\$ (0.48)	\$ (1.35)	\$ (1.75)

For the purpose of presenting pro forma information required under SFAS 123, the fair value option grant has been estimated on the date of grant using the minimum value method for grants through the period of November 22, 1999 (the date of the Company's initial public offering) and the Black-Scholes option pricing model for grants made after the Company became a public entity. The following assumptions were used for the years 2002, 2001 and 2000: dividend yield of 0.00% for all periods; risk-free interest rate of 4.8%, 6% and 6% respectively; an expected life of 3-years for all periods; a volatility rate of 150%, 70% and 70% respectively.

Because the determination of the fair value of all options granted after the Company became a public entity included an expected volatility factor, in addition to the factors described in the preceding paragraph and since additional option grants are expected to be made each year, the above pro forma disclosures are not representative of the pro forma effects of reported net income for future years.

s. Reclassifications

Certain previously reported amounts have been reclassified to conform with the 2001 presentation.

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - Accounts receivable, net

Accounts receivable are stated net of an allowance for doubtful accounts of \$81,000 and 1,356,000 at December 31, 2002 and 2001, respectively.

Note 4 - Prepaid expenses and other current assets

Prepaid expenses and other current assets consist of the following:

	December 31,	
	2002	2001
	(\$ in thousands)	
Government of Israel (VAT refund and other)	\$ 26	\$ 57
Deposits with suppliers.....	378	380
Prepaid expenses	350	714
Other	6	113
Total prepaid expenses and other current assets	\$ 760	\$ 1,264

Note 5 - Other current liabilities

Other current liabilities consist of the following:

	December 31,	
	2002	2001
	(\$ in thousands)	
Accrued expenses.....	\$ 977	\$ 1,143
Employees and related expenses.....	1,127	1,582
Other.....	226	110
Total other current liabilities.....	\$ 2,330	\$ 2,835

Note 6 - Severance pay obligations

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

Expenses relating to employee termination benefits were \$ 5,000, \$ 128,000 and \$ 101,000 for the years ended December 31, 2002, 2001 and 2000, respectively.

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Commitments and contingencies

a. Lease commitments

The Company leases offices in New York City for the headquarters of its United States operation with an initial cost of approximately \$650,000, increasing annually to \$870,000 during the final year of the lease. The lease extends until July 2010 with an option to extend the lease for an additional five years.

In addition, the Company leases offices in Israel at an annual cost of \$ 292,000. The lease term that expired on February 2003 contained an option to extend the lease for up to an additional five years. In June 2002 the Company signed an extension agreement for an additional three years, commencing February 2003, at an annual cost of \$201,600.

b. Legal proceedings

On October 8, 1999, Aerotel, Ltd. and Aerotel U.S.A. commenced a suit against the Company, RSL COM and an RSL COM subsidiary in the United States District Court for the Southern District of New York. Aerotel alleges that the Company is infringing on a patent issued to Aerotel in November 1987 by making, using, selling and offering for sale prepaid telephone card products in the United States. Aerotel seeks an injunction to stop the Company and its co-defendant from using the technology covered by this patent, monetary damages in an unspecified amount and reimbursement of attorneys' fees. The Company has answered the complaint, and the parties are currently still engaged in a pre-trial discovery. As the Company continues to evaluate these claims, the Company believes that it has meritorious defenses to the claim and it intends to defend the lawsuit vigorously. However, the outcome of the litigation is inherently unpredictable and an unfavorable result may have a material adverse effect on the Company's business, financial condition and results of operations. Regardless of the ultimate outcome, the litigation could result in substantial expenses to the Company and significant diversion of efforts by the Company's managerial and other personnel.

The Company, as well as certain of its former officers and directors, has been named as a defendant in a number of purported securities class actions in Federal District Court for the Southern District of New York, arising out of the Company's initial public offering in November 1999 (the "IPO"). Various underwriters of the IPO also are named as defendants in the actions. The complaints allege, among other things, that the registration statement and prospectus filed with the Securities and Exchange Commission for purposes of the IPO were false and misleading because they failed to disclose that the underwriters allegedly (i) solicited and received commissions from certain investors in exchange for allocating to them shares of the Company stock in connection with the IPO and (ii) entered into agreements with their customers to allocate such stock to those customers in exchange for the customers agreeing to purchase additional Company shares in the aftermarket at predetermined prices. On August 8, 2001, the court ordered that these actions, along with hundreds of IPO allocation cases against other issuers, be transferred to Judge Scheindlin for coordinated pre-trial proceedings. At a status conference held on September 7, 2001, Judge Scheindlin adjourned all defendants' time to respond to the complaints until further order of the Court. These cases remain at a preliminary stage and no discovery proceedings have taken place. The Company believes that the claims asserted against it in these cases are without merit and intends to defend vigorously against them.

On February 12, 2003 the Company announced that four lawsuits had been filed against the Company, their officers and directors, and their majority stockholder, Atarey Hasharon Chevra Lepituach Vehashkaot Benadlan (1991) Ltd. ("Atarey"), in connection with the proposal by Atarey to purchase all of the Company's outstanding shares of common stock not held by Atarey and its affiliates. On February 6, 2003, the Company issued a press release in connection with the proposed transaction. The lawsuits purport to be class actions on behalf of the Company's public stockholders. The plaintiffs in these actions have asserted a variety of claims, including allegations that Atarey's proposed tender offer price for the Company's publicly held shares is unfair and grossly inadequate; and that the Company's officers and directors have breached their fiduciary duties to the public stockholders. Each of the lawsuits has been filed in the Delaware Court of Chancery in and for New Castle County. The Company does not believe that these lawsuits state valid claims against the Company or any of the Company's officers or directors.

c. Other marketing and cooperation agreements

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

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 - Stockholders' equity

a. Share capital

Following the Company's initial public offering, effective December 1999, the Company's Class A common stock was listed on the NASDAQ National Market System. . Holders of the Class A common stock are entitled to one vote per share. The Company also issued Class B shares to RSL COM, (which carried ten votes per share). Each share of Class B common stock was convertible into one share of Class A common stock at any time.

In June 2001 Atarey acquired the controlling interest in the Company. As part of the transaction all Class B shares were converted to Class A shares (see Note 1).

On September 17, 2002 the listing of the Company's common stock was transferred from the Nasdaq National Market to the Nasdaq SmallCap Market.

b. CNET transaction

On October 20, 1999, the Company issued to CNET Investments, Inc. ("CNET") 1,085,943 shares of common stock and a warrant to purchase 466,028 shares of Class A common stock at an exercise price of \$ 19.31 per share, or approximately \$ 11.0 million in the aggregate, which was received in cash by the Company upon the issuance of the shares. The Company recorded approximately \$ 2.7 million of deferred compensation expense in 1999 related to the issuance of the shares representing the difference between each of the purchase price of the Class A common stock as compared to the initial public offering price of the Class A common stock and the issuance of the warrant (using the Black-Scholes option pricing model for determining the fair value of the warrant). Amortization of the deferred compensation for the year ended December 31, 2000 amounted to \$ 1,062,000. On July 6, 2001, CNET entered into a share purchase agreement with Atarey (the "CNET Purchase Agreement"). Under the CNET Purchase Agreement, among other things, Atarey purchased all of the shares owned by CNET in accordance with the "tag-along" rights granted to CNET pursuant to their purchase. In addition, the Company entered into a binding development and promotion agreement with CNET in September 1999, which was amended effective July 1, 2000, whereby CNET provided various promotions to the Company to assist it in promoting its PC-to-Phone product and related services. In consideration for these services, the Company was obligated to pay CNET a total of \$11,000,000.

In May 2001 the agreement with CNET was terminated. The Company incurred a one-time expense of approximately \$3,628,000 resulting from the cancellation of the agreement. Expenses included a payment to terminate the contract of \$1,750,000, the acceleration of the amortization of compensation charges deferred in previous years of \$1,493,000 and other related expenses.

c. Stock Options

In November 1999, the Company adopted the 1999 Stock Incentive Plan ("the Plan"). Under the Plan, 4,000,000 shares of Class A were reserved for issuance upon exercise of awards to be granted. In addition, the Company's compensation committee may grant both incentive and non-incentive stock options for shares of Class A common stock of the Company. The options generally have a term of seven years and become exercisable in three equal installments commencing on the first anniversary of the date of the grant. The purchase price per share payable upon exercise of an option is no less than the fair market value of the share at the date of grant.

As of December 31, 2002, options to purchase 3,449,520 shares of Class A were outstanding with exercise prices ranging between \$ 0.004 and \$15.00 per share.

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 - Stockholders' equity (contd.)

A summary of the status of the Company's stock option plans as of December 31, 2002 and 2001 and changes during the years then ended, is presented below:

	<u>December 31, 2002</u>		<u>December 31, 2001</u>		<u>December 31, 2000</u>	
	<u>Shares</u>	<u>Weighted average Exercise price</u>	<u>Shares</u>	<u>Weighted average Exercise price</u>	<u>Shares</u>	<u>Weighted average Exercise price</u>
Options outstanding at beginning of year	2,591,205	\$ 4.24	1,626,843	\$ 8.72	1,952,537	\$ 7.54
Granted during the year	1,335,348	0.98	1,978,416	3.68	475,000	7.85
Exercised during the year	16,566	0.004	50,961	0.004	319,229	4.10
Forfeited during the year	460,467	5.20	963,093	8.77	481,465	6.54
Outstanding at end of year	<u>3,449,520</u>	<u>2.87</u>	<u>2,591,205</u>	<u>4.24</u>	<u>1,626,843</u>	<u>8.72</u>
Weighted average fair value of options granted during the year ..	<u>\$ 0.95</u>		<u>\$ 2.39</u>		<u>\$ 4.00</u>	

d. Employee Stock Purchase Plan

During 1999, the Board of Directors approved an Employee Stock Purchase Plan (the "ESPP"), effective beginning November 23, 1999. Under the ESPP, the maximum number of shares to be made available under the ESPP is 5% of the number of outstanding shares.

All full-time employees who have been employed by the Company for at least one calendar quarter are eligible to participate in the ESPP. Employee stock purchases are made through payroll deductions. Under the terms of the ESPP, employees may not deduct an amount that exceeds \$25,000 in total value of stock in any one year. The purchase price of the stock will be the lower of 85% of the fair market value on the first trading day of the offering period or the last trading day of the purchase period. The ESPP shall terminate upon the first to occur of (i) December 31, 2009 or (ii) the date on which the ESPP is terminated by the Board of Directors. During 2002, there were no purchases of shares under the ESPP.

Note 9 - Research and development expenses, net

Research and development expenses consist of the following:

	<u>Year ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
	(\$ in thousands)		
Salaries and related expenses.....	\$ 2,462	\$ 3,255	\$ 5,388
Consulting and advisory fees	78	655	—
Travel	41	126	344
Other.....	854	1,612	893
Total research and development expenses	<u>\$ 3,435</u>	<u>\$ 5,648</u>	<u>\$ 6,625</u>

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 - Write-down of fixed assets

In 2001 the Company incurred a one-time expense of approximately \$1,003,000 from the write down of equipment that was purchased in previous periods to support contracts and inter-company agreements between RSL COM and the Company that were cancelled at the time of RSL COM's sale of their majority ownership interest in the Company to Atarey in accordance with FAS 121 (See Note1).

Note 11 - Impairment of goodwill

During 2001, the telecommunications industries experienced significant and rapid contraction, which was accompanied by a decrease in revenues. In the fourth quarter of fiscal 2001 the Company assessed the value and future benefit of its goodwill pursuant to Accounting Principles Board Opinion No. 17, Intangible Assets ("APB 17") and consequently made a full write-off of the goodwill in the amount of \$4,151,000.

In February 2000, the Company issued 227,738 shares of Class A common stock, at an average market price of \$46 per share, amounting to \$ 10,500,000 in the aggregate to acquire all the outstanding shares of YourDay.com, Inc. In November 2000, the Company decided to deemphasize its consumer business, and communications portal, and focus on generating revenues primarily through sales of its Hosted Communications Solution. As a result, the Yourday.com technology was not incorporated into the Company's offerings. Accordingly, the Company recorded a full write-off of the Yourday.com technology in the amount of \$ 8,905,000.

Note 12 - Income taxes

a. Tax loss carryforwards

As of December 31, 2002, the Company had net operating loss carryforwards generated in the U.S. and Israel of approximately \$119,143,000 and \$ 7,511,000, respectively. The Company's U.S. net operating loss carryforwards will expire at various dates beginning in 2011 if not utilized. In addition, a portion of those net operating loss carryforwards could be subject to limitation due to changes in ownership of the Company. The Company's net operating losses generated in Israel may be carried forward indefinitely.

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

	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
	(\$ in thousands)	
Net operating losses carryforwards	\$ 45,595	\$ 41,245
Less valuation allowance.....	<u>(45,595)</u>	<u>(41,245)</u>
Net deferred tax assets.....	<u>\$ -</u>	<u>\$ -</u>

As of December 31, 2002, and 2001, a valuation allowance of \$45,595,000, and \$41,245,000 respectively, is provided as the realization of the deferred tax assets are not assured.

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 - Segment reporting, geographical information and major customers

The Company operates in a single industry segment, IP communications services, and makes business decisions and allocates resources accordingly.

	<u>2002</u>	<u>December 31,</u> <u>2001</u>	<u>2000</u>
		(\$ in thousands)	
Revenues by geographical location:			
United States.....	\$ 5,077	\$ 9,123	\$ 20,862
Europe.....	984	2,654	5,289
Argentina	903	-	-
Far east.....	1,109	1,413	3,162
Other	4,856	2,470	1,063
Total revenues	<u>\$ 12,929</u>	<u>\$ 15,660</u>	<u>\$ 30,376</u>
Revenues from major customers:			
Affiliates	<u>\$ -</u>	<u>\$ 1,669</u>	<u>\$ 13,977</u>

	<u>December 31,</u> <u>2002</u>	<u>2001</u>
	(\$ in thousands)	
Long-lived assets:		
United States.....	\$ 7,054	\$ 11,864
Israel	1,554	1,797
Europe.....	690	1,426
Other	154	548
Total long-lived assets.....	<u>\$ 9,452</u>	<u>\$ 15,635</u>

DELTATHREE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 14 - Selected Quarterly Financial Information (Unaudited)

	<u>March 31</u>	<u>Three Months Ended,</u>		
		<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
	(\$ in thousands, except per share data)			
2002				
Total revenues	\$ 3,337	\$ 3,154	\$ 3,214	\$ 3,224
Costs and operating expenses:				
Cost of revenues, net	2,557	2,179	2,193	2,005
Research and development expenses, net	992	880	772	790
Selling and marketing expenses	1,051	1,168	808	883
General and administrative expenses (exclusive of non cash compensation expense shown below)	610	511	623	415
Non cash compensation expense	162	108	-	-
Depreciation and amortization	1,635	1,643	1,675	1,653
Total costs and operating expenses	<u>7,007</u>	<u>6,489</u>	<u>6,071</u>	<u>5,746</u>
Loss from operations	(3,670)	(3,335)	(2,857)	(2,552)
Interest income (expense), net	129	52	194	73
Loss before income taxes	(3,541)	(3,283)	(2,663)	(2,449)
Income taxes	11	-	45	85
Net loss	<u>\$ (3,552)</u>	<u>\$ (3,283)</u>	<u>\$ (2,708)</u>	<u>\$ (2,534)</u>
Net loss per share - basic and diluted	<u>\$ (0.12)</u>	<u>\$ (0.11)</u>	<u>\$ (0.09)</u>	<u>\$ (0.09)</u>
Weighted average number of shares outstanding - basic and diluted	<u>28,885,606</u>	<u>28,885,606</u>	<u>28,885,606</u>	<u>28,898,738</u>
2001				
Total revenues	\$ 6,026	\$ 2,841	\$ 3,418	\$ 3,375
Costs and operating expenses:				
Cost of revenues, net	5,339	2,526	2,820	2,803
Research and development expenses, net	1,836	1,527	1,279	1,005
Selling and marketing expenses	3,214	1,921	1,488	1,177
General and administrative expenses (exclusive of non cash compensation expense shown below)	2,050	1,628	1,228	2,075
Non cash compensation expense	268	233	162	162
Depreciation and amortization	1,971	2,490	2,758	1,632
Write-down of fixed assets	-	1,147	-	-
Expenses due to cancellation of agreement with a (including non-cash compensation of \$1,493)	-	3,628	-	-
Impairment of goodwill	-	-	-	4,151
Total costs and operating expenses	<u>14,678</u>	<u>15,100</u>	<u>9,735</u>	<u>13,005</u>
Loss from operations	(8,652)	(12,259)	(6,317)	(9,630)
Interest income (expense), net	732	527	232	186
Loss before income taxes	(7,920)	(11,732)	(6,085)	(9,444)
Income taxes	69	(181)	106	558
Net loss	<u>\$ (7,989)</u>	<u>\$ (11,551)</u>	<u>\$ (6,191)</u>	<u>\$ (10,002)</u>
Net loss per share - basic and diluted	<u>\$ (0.27)</u>	<u>\$ (0.40)</u>	<u>\$ (0.21)</u>	<u>\$ (0.34)</u>
Weighted average number of shares outstanding - basic and diluted	<u>29,056,413</u>	<u>29,055,783</u>	<u>29,129,604</u>	<u>29,029,061</u>

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment No. 1 to its Annual Report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized, in New York, New York on April 22, 2003.

DELTATHREE, INC.

By:

/s/ Paul C. White

Paul C. White

Chief Financial Officer

CERTIFICATIONS

I, Shimmy Zimels, certify that:

1. I have reviewed this annual report on Form 10-K/A of deltathree, Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures 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 annual report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 22, 2003

/s/ Shimmy Zimels
Shimmy Zimels
Title: Chief Executive Officer and President
(Principal Executive Officer)

I, Paul C. White, certify that:

1. I have reviewed this annual report on Form 10-K/A of deltathree, Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures 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 annual report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
 - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 22, 2003

/s/ Paul C. White
Paul C. White
Title: Chief Financial Officer
(Principal Financial Officer)



Founded in 1996, deltathree is a leading provider of hosted SIP-based VoIP products and services. deltathree provides private-label products, including PC-to-Phone, Phone-to-Phone, and Broadband Phone, as well as back-office services such as billing, operations management, marketing support, and network management to service providers worldwide. deltathree's consumer division, iConnectHere, provides award-winning VoIP products directly to consumers. Our high quality Internet telephony solutions are viable and cost-effective alternatives to traditional telephone services.

