

**The Public Utilities Commission of Ohio**  
**TELECOMMUNICATIONS APPLICATION FORM for ROUTINE PROCEEDINGS**  
(Effective: 01/18/2008)

In the Matter of the Application of iBasis Retail, Inc. )  
to Provide Interexchange Intrastate Resold Services )  
) )  
) )

TRF Docket No. 90-\_\_\_\_\_

Case No. 09 - 923 - **TP** - **ACE**

NOTE: Unless you have reserved a Case # or are filing a Contract, leave the "Case No" fields BLANK.

Name of Registrant(s) iBasis Retail, Inc.  
DBA(s) of Registrant(s) iBasis  
Address of Registrant(s) 20 Second Avenue, Burlington, MA 01803  
Company Web Address http://www.ibasis.net  
Regulatory Contact Person(s) Ellen Schmidt, Senior Counsel Phone 781-505-7956 Fax 781-505-7304  
Regulatory Contact Person's Email Address eschmidt@ibasis.net  
Contact Person for Annual Report Ellen Schmidt, Senior Counsel Phone 781-505-7956  
Address (if different from above) Same  
Consumer Contact Information Rachel Albert, Senior Manager Quality Analysis Phone 781-505-7984  
Address (if different from above) Same  
Motion for protective order included with filing? ☐ Yes ☒ No  
Motion for waiver(s) filed affecting this case? ☐ Yes ☒ No [Note: Waivers may toll any automatic timeframe.]

**Section I – Pursuant to Chapter 4901:11-6 OAC – Part I – Please indicate the Carrier Type and the reason for submitting this form by checking the boxes below. CMRS providers: Please see the bottom of Section II.**

NOTES: (1) For requirements for various applications, see the identified section of Ohio Administrative Code Section 4901 and/or the supplemental application form noted.

(2) Information regarding the number of copies required by the Commission may be obtained from the Commission's web site at [www.puco.ohio.gov](http://www.puco.ohio.gov) under the docketing information system section, by calling the docketing division at 614-466-4095, or by visiting the docketing division at the offices of the Commission.

Carrier Type <input type="checkbox"/> Other (explain below)	<input type="checkbox"/> ILEC	<input type="checkbox"/> CLEC	<input checked="" type="checkbox"/> CTS	<input type="checkbox"/> AOS/IOS
<b>Tier 1 Regulatory Treatment</b>				
Change Rates within approved Range	<input type="checkbox"/> TRF 1-6-04(B) (0 day Notice)	<input type="checkbox"/> TRF 1-6-04(B) (0 day Notice)		
New Service, expanded local calling area, correction of textual error	<input type="checkbox"/> ZTA 1-6-04(B) (0 day Notice)	<input type="checkbox"/> ZTA 1-6-04(B) (0 day Notice)		
Change Terms and Conditions, Introduce non-recurring service charges	<input type="checkbox"/> ATA 1-6-04(B) (Auto 30 days)	<input type="checkbox"/> ATA 1-6-04(B) (Auto 30 days)		
Introduce or Increase Late Payment or Returned Check Charge	<input type="checkbox"/> ATA 1-6-04(B) (Auto 30 days)	<input type="checkbox"/> ATA 1-6-04(B) (Auto 30 days)		
Business Contract	<input type="checkbox"/> CTR 1-6-17 (0 day Notice)	<input type="checkbox"/> CTR 1-6-17 (0 day Notice)		
Withdrawal	<input type="checkbox"/> ATW 1-6-12(A) (Non-Auto)	<input type="checkbox"/> ATW 1-6-12(A) (Auto 30 days)		
Raise the Ceiling of a Rate	Not Applicable	<input type="checkbox"/> SLF 1-6-04(B) (Auto 30 days)		
<b>Tier 2 Regulatory Treatment</b>				
Residential - Introduce non-recurring service charges	<input type="checkbox"/> TRF 1-6-05(E) (0 day Notice)	<input type="checkbox"/> TRF 1-6-05(E) (0 day Notice)		
Residential - Introduce New Tariffed Tier 2 Service(s)	<input type="checkbox"/> TRF 1-6-05(C) (0 day Notice)	<input type="checkbox"/> TRF 1-6-05(C) (0 day Notice)	<input type="checkbox"/> TRF 1-6-05(C) (0 day Notice)	
Residential - Change Rates, Terms and Conditions, Promotions, or Withdrawal	<input type="checkbox"/> TRF 1-6-05(E) (0 day Notice)	<input type="checkbox"/> TRF 1-6-05(E) (0 day Notice)	<input type="checkbox"/> TRF 1-6-05(E) (0 day Notice)	
Residential - Tier 2 Service Contracts	<input type="checkbox"/> CTR 1-6-17 (0 day Notice)	<input type="checkbox"/> CTR 1-6-17 (0 day Notice)	<input type="checkbox"/> CTR 1-6-17 (0 day Notice)	
Commercial (Business) Contracts	Not Filed	Not Filed	Not Filed	
Business Services (see "Other" below)	Detariffed	Detariffed	Detariffed	
Residential & Business Toll Services (see "Other" below)	Detariffed	Detariffed	Detariffed	

## Section I – Part II – Certificate Status and Procedural

Certificate Status	ILEC	CLEC	CTS	AOS/IOS
Certification (See Supplemental ACE form)		<input type="checkbox"/> ACE <u>1-6-10</u> (Auto 30 days)	<input checked="" type="checkbox"/> ACE <u>1-6-10</u> (Auto 30 days)	<input type="checkbox"/> ACE <u>1-6-10</u> (Auto 30 days)
Add Exchanges to Certificate	<input type="checkbox"/> ATA <u>1-6-09(C)</u> (Auto 30 days)	<input type="checkbox"/> AAC <u>1-6-10(F)</u> (0 day Notice)	CLECs must attach a current CLEC Exchange Listing Form	
Abandon all Services - With Customers	<input type="checkbox"/> ABN <u>1-6-11(A)</u> (Non-Auto)	<input type="checkbox"/> ABN <u>1-6-11(A)</u> (Auto 90 day)	<input type="checkbox"/> ABN <u>1-6-11(B)</u> (Auto 14 day)	<input type="checkbox"/> ABN <u>1-6-11(B)</u> (Auto 14 day)
Abandon all Services - Without Customers		<input type="checkbox"/> ABN <u>1-6-11(A)</u> (Auto 30 days)	<input type="checkbox"/> ABN <u>1-6-11(B)</u> (Auto 14 day)	<input type="checkbox"/> ABN <u>1-6-11(B)</u> (Auto 14 day)
Change of Official Name (See below)	<input type="checkbox"/> ACN <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> ACN <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)
Change in Ownership (See below)	<input type="checkbox"/> ACO <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> ACO <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)
Merger (See below)	<input type="checkbox"/> AMT <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> AMT <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)
Transfer a Certificate (See below)	<input type="checkbox"/> ATC <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> ATC <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)
Transaction for transfer or lease of property, plant or business (See below)	<input type="checkbox"/> ATR <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> ATR <u>1-6-14(B)</u> (Auto 30 days)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)	<input type="checkbox"/> CIO <u>1-6-14(A)</u> (0 day Notice)
<b>Procedural</b>				
Designation of Process Agent(s)	<input type="checkbox"/> TRF (0 day Notice)	<input type="checkbox"/> TRF (0 day Notice)	<input type="checkbox"/> TRF (0 day Notice)	<input type="checkbox"/> TRF (0 day Notice)

## Section II – Carrier to Carrier (Pursuant to 4901:1-7), CMRS and Other

Carrier to Carrier	ILEC	CLEC		
Interconnection agreement, or amendment to an approved agreement	<input type="checkbox"/> NAG <u>1-7-07</u> (Auto 90 day)	<input type="checkbox"/> NAG <u>1-7-07</u> (Auto 90 day)		
Request for Arbitration	<input type="checkbox"/> ARB <u>1-7-09</u> (Non-Auto)	<input type="checkbox"/> ARB <u>1-7-09</u> (Non-Auto)		
Introduce or change c-t-c service tariffs,	<input type="checkbox"/> ATA <u>1-7-14</u> (Auto 30 day)	<input type="checkbox"/> ATA <u>1-7-14</u> (Auto 30 day)		
Introduce or change access service pursuant to 07-464-TP-COI	<input type="checkbox"/> ATA (Auto 30 day)			
Request rural carrier exemption, rural carrier suspension or modification	<input type="checkbox"/> UNC <u>1-7-04</u> or <u>1-7-05</u> (Non-Auto)	<input type="checkbox"/> UNC <u>1-7-04</u> or <u>1-7-05</u> (Non-Auto)		
Pole attachment changes in terms and conditions and price changes.	<input type="checkbox"/> UNC <u>1-7-23(B)</u> (Non-Auto)	<input type="checkbox"/> UNC <u>1-7-05</u> (Non-Auto)		
<b>CMRS Providers</b> See 4901:1-6-15	<input type="checkbox"/> RCC [Registration & Change in Operations] (0 day)		<input type="checkbox"/> NAG [Interconnection Agreement or Amendment] (Auto 90 days)	
<b>Other*</b> (explain) _____				

\*NOTE: During the interim period between the effective date of the rules and an Applicant's Detariffing Filing, changes to existing business Tier 2 and all toll services, including the addition of new business Tier 2 and all new toll services, will be processed as 0-day TRF filings, and briefly described in the "Other" section above.

All Section I and II applications that result in a change to one or more tariff pages require, at a minimum, the following exhibits. Other exhibits may be required under the applicable rule(s). ACN, ACO, AMT, ATC, ATR and CIO applications see the 4901:1-6-14 Filing Requirements on the Commission's Web Page for a complete list of exhibits.

Exhibit	Description:
A	The tariff pages subject to the proposed change(s) as they exist before the change(s)
B	The Tariff pages subject to the proposed change(s), reflecting the change, with the change(s) marked in the right margin.
C	A short description of the nature of the change(s), the intent of the change(s), and the customers affected.
D	A copy of the notice provided to customers, along with an affidavit that the notice was provided according to the applicable rule(s).

**Section III. – Attestation**

**Registrant hereby attests to its compliance with pertinent entries and orders issued by the Commission.**

**AFFIDAVIT**

***Compliance with Commission Rules and Service Standards***

I am an officer/agent of the applicant corporation, Mark Flynn, and am authorized to make this statement on its behalf.  
(Name)

I attest that these tariffs comply with all applicable rules, including the Minimum Telephone Service Standards (MTSS) Pursuant to Chapter 4901:1-5 OAC for the state of Ohio. I understand that tariff notification filings do not imply Commission approval and that the Commission's rules, including the Minimum Telephone Service Standards, as modified and clarified from time to time, supersede any contradictory provisions in our tariff. We will fully comply with the rules of the state of Ohio and understand that noncompliance can result in various penalties, including the suspension of our certificate to operate within the state of Ohio.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on (Date) August 27, 2009 at (Location) Burlington, Ma.  
\*(Signature and Title) Mark S. Flynn (Date) 8-27-09

- This affidavit is required for every tariff-affecting filing. It may be signed by counsel or an officer of the applicant, or an authorized agent of the applicant.

**VERIFICATION**

I, Mark S. Flynn  
verify that I have utilized the Telecommunications Application Form for Routine Proceedings provided by the Commission and that all of the information submitted here, and all additional information submitted in connection with this case, is true and correct to the best of my knowledge.

\*(Signature and Title) Mark S. Flynn (Date) 8-27-09

*\*Verification is required for every filing. It may be signed by counsel or an officer of the applicant, or an authorized agent of the applicant.*

***Send your completed Application Form, including all required attachments as well as the required number of copies, to:***

**Public Utilities Commission of Ohio  
Attention: Docketing Division  
180 East Broad Street, Columbus, OH 43215-3793**

***Or***

***Make such filing electronically as directed in Case No 06-900-AU-WVR***

**The Public Utilities Commission of Ohio**  
**TELECOMMUNICATIONS SUPPLEMENTAL APPLICATION FORM**  
**for CARRIER CERTIFICATION**

(Effective: 09/19/2007)

(Pursuant to Case Nos. 06-1344-TP-ORD and 06-1345-TP-ORD)

NOTE: This SUPPLEMENTAL form must be used WITH the  
TELECOMMUNICATIONS APPLICATION FORM for ROUTINE PROCEEDINGS.

In the Matter of the Application of iBasis Retail, Inc. )  
to Provide Interexchange Intrastate Resold Services )  
 )  
 )

Case No. 09 - 923 - **TP** - ACE

Name of Registrant(s) iBasis Retail, Inc.

DBA(s) of Registrant(s) iBasis

Address of Registrant(s) 20 Second Avenue, Burlington, MA 01803

Motion for protective order included with filing? ☐ Yes ☒ No

Motion for waiver(s) filed affecting this case? ☐ Yes ☒ No [Note: waiver(s) tolls any automatic timeframe]

**List of Required Exhibits**

**Tariffs: (Include all that apply)**

☒ Interexchange Tariff<sup>1</sup>

☐ Local Tariff<sup>1</sup>

☐ Carrier-to-Carrier (Access) Tariff

**Description of Services**

NOTE: All Facilities-Based carriers must file an Access Tariff

☒ Service provisioned via Resale

☐ Service provisioned via Facilities

☐ Both Resold and Facilities-based

☒ Description of Proposed Services

☒ Statement about the provision of  
CTS services

☒ Description of the proposed  
market area

☒ Explanation of how the proposed  
services in the proposed market  
area are in the public interest.

☒ Description of the class of customers (e.g., residence, business) that the  
applicant intends to serve

**Business Requirements**

**Evidence of Registration with:**

☒ Ohio Department of Taxation

☒ Ohio Secretary of State<sup>2</sup> &  
Certificate of Good Standing

**Documentation attesting to the applicant's financial viability, including the following:**

☒ An executive Summary describing the applicant's current financial condition, liquidity, and capital resources. Describe internally generated sources of cash and external funds available to support the applicant's operations that are the subject of this certification application.

☒ Copy of financial statements (actual and pro forma income statement and a balance sheet). Indicate if financial statements are based on a certain geographical area(s) or information in other jurisdictions

☒ Documentation to support the applicant's cash and funding sources. See Exhibits E and F.

**Documentation attesting to the applicant's managerial ability and corporate structure, including the following:**

☒ Documentation attesting to the applicant's technical and managerial expertise relative to the proposed service offering(s) and proposed service area

☒ List of names, addresses, and phone numbers of officers and directors, or partners.

☒ Documentation indicating the applicant's corporate structure and ownership

☒ Information regarding any similar operations in other states.

If this company has been previously certified in the State of Ohio, include that certification number N/A

<sup>1</sup> Detariffed services are regulated but not required to be filed in a tariff. For purposes of Certification, all detariffed services offered must be provided as an exhibit.

<sup>2</sup> Certification from Ohio Secretary of State (domestic or foreign corporation, authorized use of fictitious name, etc.), and Certificate of Good Standing is required.

- ☒ Verification that the applicant will maintain local telephony records separate and apart from any other accounting records in accordance with the GAAP.

**Documentation attesting to the applicant's managerial ability and corporate structure (cont'd):**

- ☒ Verification of compliance with any affiliate transaction requirements

**Documentation attesting to the applicant's proposed interactions with other Carriers** Not applicable.

- ☐ Explanation as to whether rates are derived through (check all applicable):

☐ interconnection agreement

☐ retail tariffs

☐ resale tariffs

- ☐ Explanation as to which service areas company currently has an approved interconnection or resale agreement.

- ☐ A notarized affidavit accompanied by bona fide letters requesting negotiation pursuant to Sections 251 and 252 of the Telecommunications Act of 1996 and a proposed timeline for construction, interconnection, and offering of services to end users.

**Documentation attesting to the applicant's proposed interactions with Customers** Not applicable.

- ☐ Explanation of whether applicant intends to provide Local Services which require payment in advance of Customer receiving dial tone.

- ☐ Tariff sheet(s) listing the services and associated charges that must be paid prior to customer receiving dial tone (if applicable)

- ☐ A sample copy of the customer bill and disconnection notice the applicant plans to utilize.

- ☐ Provide a copy of any customer application form required in order to establish residential service, if applicable.

- ☐ For CLECs, List of Ohio ILEC Exchanges the applicant intends to serve  
(Use spreadsheet from: [http://www.puc.state.oh.us/puco/forms/form.cfm?doc\\_id=357](http://www.puc.state.oh.us/puco/forms/form.cfm?doc_id=357))

- ☐ If Mirroring the entire ILEC exchanges for both serving area and local calling areas, tariffs may incorporate by reference. If not mirroring the entire ILEC serving and/or local calling areas, the CLEC shall specifically define their service and local calling areas in the tariff.

**Affidavit**

I am an authorized representative of the applicant corporation Mark Flynn  
(Name)

and I am authorized to make this statement on its behalf. I attest that I have utilized the Telecommunications Supplemental Application Form for Carrier Certification provided by the Commission, and that all of the information submitted here, and all additional information submitted in connection with this case, is true and correct.

Executed on August 27, 2009 at Burlington, Ma.  
[Signature], VP & Secretary 8-27-09  
(Signature and Title) (Date)

## **EXHIBITS**

- Exhibit A:** Interexchange Tariff (Exhibit of Detariffed Services Offered)
- Exhibit B:** Description of Services
- Exhibit C:** Evidence of Registration with the Ohio Department of Taxation
- Exhibit D:** Certification from Ohio Secretary of State and Certificate of Good Standing
- Exhibit E:** Summary of Financial Qualifications
- Exhibit F:** Financial Statements of iBasis, Inc.
- Exhibit G:** Summary of Technical and Managerial Expertise
- Exhibit H:** List of Officers and Directors
- Exhibit I:** Organizational Chart Depicting Applicant's Corporate Structure and Ownership
- Exhibit J:** Information regarding Similar Operations in Other States
- Exhibit K:** Verification regarding Accounting Records
- Exhibit L:** Verification regarding Compliance with Affiliate Transaction Requirements

### **NOTE:**

**Exhibits containing documentation attesting to Applicant's proposed interactions with other carriers and customers are not applicable because Applicant offers prepaid calling card services only.**

## **Exhibit A**

### **Interexchange Tariff (Exhibit of Detariffed Services Offered)**

TITLE PAGE  
  
INTEREXCHANGE TELECOMMUNICATIONS SERVICES TARIFF  
  
OF  
  
iBASIS RETAIL, INC.

Customers have certain rights and responsibilities under the Minimum Telephone Service Standards (Ohio Adm. Code 4901:1-5)(MTSS). These safeguards can be found in the Appendix to Ohio Adm. Code 4901:1-5-03, which is entitled "Telephone Customer Rights and Responsibilities." **These rights and responsibilities include complaint handling, ordering or charging service, service repair, payment of bills, and disconnection and reconnection of service.**

Issued Date:

Issued By: Tony Bloom, Vice President  
iBasis Retail, Inc.  
20 Second Avenue  
Burlington, MA 01803

Effective Date:



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**Issued Date:**

**Issued By: Tony Bloom, Vice President  
iBasis Retail, Inc.  
20 Second Avenue  
Burlington, MA 01803**

**Effective Date:**

**RATES AND CHARGES**

**1.1 Rates and Charges for Prepaid Calling Services Are As Follows:**

A base per minute rate of up to \$.99 per minute.

A weekly fee of \$0.89 is assessed within twenty-four (24) hours after the first call and each week thereafter.

Up to a \$0.99 hang-up or connect fee will be applied at the end or start of the call.

**1.2 Payphone Surcharge**

Pursuant to the FCC's Order in CC Docket 96-128, this surcharge applies only to dial-around calls, *i.e.*, calls originating using a carrier's access code, a customer's 800 and other toll-free numbers, calling cards, and prepaid phone card calls, from payphone instruments.

The customer shall pay iBasis Retail, Inc. a per call surcharge of up to \$0.99 per call for all such traffic.

**1.3 Promotional Offerings**

iBasis Retail, Inc. may from time to time make promotional offerings available in which the rates and charges differ from the rates provided. These offerings will be limited to certain cards and dates and the Public Utilities Commission of Ohio will be notified as required of these promotions.

**1.4 Return Check Charge**

A fee in the amount of \$25.00 will be charged whenever a check or draft presented for payment for service is not accepted by the institution on which it is written.

Issued Date:

Issued By: Tony Bloom, Vice President  
iBasis Retail, Inc.  
20 Second Avenue  
Burlington, MA 01803

Effective Date:

## **Exhibit B**

### **Description of Services**

Applicant proposes to provide resold interexchange telecommunications services to all types of retail customers from all points within the State of Ohio and, therefore, seeks statewide authorization as a Competitive Telecommunications Services (“CTS”) provider. Specifically, Applicant intends to offer prepaid calling card services in the State.

Applicant’s services will be available on a full-time basis, 24 hours a day, seven (7) days a week. Customers with service and billing inquiries and complaints may reach iBasis Retail using its toll free customer service number. Applicant’s toll free customer service number for prepaid calling card services is 1-877-291-9783, and a toll free customer service number is also printed on each calling card.

Applicant does not own, operate, or control any transmission or switching equipment in the State of Ohio and therefore plans to offer its services as a non-facilities-based reseller. As a reseller, Applicant will use the facilities of certificated telecommunications carriers in Ohio to offer its services. Thus, all transmission and switching facilities are controlled by the Ohio certified carrier. In addition to its own expertise and resources, Applicant relies upon the substantial financial, managerial, and technical resources of its corporate parent, iBasis, Inc., a publicly traded corporation.

The entry of iBasis Retail into the intrastate interexchange telecommunications market in Ohio will serve the public interest by fostering greater competition in the telecommunications marketplace and by permitting customers to receive cost savings as a result of competition. Applicant’s proposed prepaid calling card services will meet the needs of customers within the State of Ohio for competitively priced, superior quality telecommunications services. Moreover,

Applicant's entry into the prepaid calling card market will positively impact the availability of affordable interexchange services by stimulating innovation and diversification in service offerings. Approval of this Application, therefore, will serve the public interest.

## **Exhibit C**

### **Evidence of Registration with the Ohio Department of Taxation**

Jennifer A. Cukier | 202 434 7383 | jacukier@mintz.com

October 8, 2009

**VIA FIRST CLASS MAIL**

Ohio Department of Taxation  
c/o Public Utility Section  
21st Floor  
30 East Broad Street  
Columbus, OH 43215-3793  
(800) 282-1780

**Re: iBasis Retail, Inc. d/b/a iBasis**

Dear Sir/Madam:

Please be advised that iBasis Retail, Inc. d/b/a iBasis intends to provide competitive telecommunications services in the State of Ohio upon receiving approval of its application filed with the Public Utilities Commission of Ohio.

Respectfully submitted,



Jennifer A. Cukier  
*Counsel for iBasis Retail, Inc.*

**Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.**

BOSTON | WASHINGTON | NEW YORK | STAMFORD | LOS ANGELES | PALO ALTO | SAN DIEGO | LONDON

## **Exhibit D**

### **Certification from Ohio Secretary of State and Certificate of Good Standing**

**\*200925300200\***

DATE	DOCUMENT ID	DESCRIPTION	FILING	EXPED	PENALTY	CERT	COPY
09/10/2009	200925300200	FOREIGN LICENSE/FOR-PROFIT (FLF)	125.00	100.00	.00	.00	.00

**Receipt**

This is not a bill. Please do not remit payment.

CT CORPORATION SYSTEM  
4400 EASTON COMMONS WAY, SUITE 125  
ATTN: TIMOTHY ROBERSON  
COLUMBUS, OH 43219

**STATE OF OHIO  
CERTIFICATE**

**Ohio Secretary of State, Jennifer Brunner**

**1876901**

It is hereby certified that the Secretary of State of Ohio has custody of the business records for  
**IBASIS RETAIL, INC.**

and, that said business records show the filing and recording of:

Document(s):

**FOREIGN LICENSE/FOR-PROFIT**

Authorization to transact business in Ohio is hereby given, until surrender, expiration or  
cancellation of this license.

Document No(s):

**200925300200**



United States of America  
State of Ohio  
Office of the Secretary of State

Witness my hand and the seal of the  
Secretary of State at Columbus, Ohio  
this 9th day of September, A.D. 2009.

A handwritten signature in cursive script, appearing to read "Jennifer Brunner".

Ohio Secretary of State



**\*200925300202\***

DATE	DOCUMENT ID	DESCRIPTION	FILING	EXPED	PENALTY	CERT	COPY
09/10/2009	200925300202	TRADE NAME/ORIGINAL FILING (RNO)	50.00	100.00	.00	.00	.00

**Receipt**

This is not a bill. Please do not remit payment.

CT CORPORATION SYSTEM  
4400 EASTON COMMONS WAY, SUITE 125  
ATTN: TIMOTHY ROBERSON  
COLUMBUS, OH 43219

**STATE OF OHIO  
CERTIFICATE**

**Ohio Secretary of State, Jennifer Brunner**

**1882094**

It is hereby certified that the Secretary of State of Ohio has custody of the business records for

**IBASIS**

and, that said business records show the filing and recording of:

Document(s):

**TRADE NAME/ORIGINAL FILING**

Date of First Use: 09/09/2009

Expiration Date: 09/09/2014

Document No(s):

**200925300202**

IBASIS RETAIL, INC.  
20 SECOND AVENUE  
BURLINGTON, MA 01803



United States of America  
State of Ohio  
Office of the Secretary of State

Witness my hand and the seal of the  
Secretary of State at Columbus, Ohio  
this 9th day of September, A.D. 2009.

A handwritten signature in cursive script, appearing to read "Jennifer Brunner".

Ohio Secretary of State

**United States of America  
State of Ohio  
Office of the Secretary of State**

***I, Jennifer Brunner, do hereby certify that I am the duly elected, qualified and present acting Secretary of State for the State of Ohio, and as such have custody of the records of Ohio and Foreign business entities; that said records show IBASIS RETAIL, INC., a Delaware corporation, having qualified to do business within the State of Ohio on September 09, 2009 under License No. 1876901 is currently in GOOD STANDING upon the records of this office.***



*Witness my hand and the seal of the  
Secretary of State at Columbus, Ohio  
this 15th day of September, A.D. 2009*

A handwritten signature in cursive script, appearing to read "Jennifer Brunner".

Ohio Secretary of State

Validation Number: V2009258S3E400

## **Exhibit E**

### **Summary of Financial Qualifications**

Applicant is financially qualified to render the proposed services. Applicant is a wholly-owned subsidiary of iBasis, Inc., a publicly traded company. In support of this Application, attached at Exhibit F is a copy of iBasis, Inc.'s latest quarterly and annual public financial statements as filed with the Securities and Exchange Commission. The combination of iBasis Retail's technical and managerial experience and the financial backing of iBasis, Inc., a publicly traded corporation and international provider of VoIP-based telecommunications services with access to capital markets, makes iBasis Retail well qualified to provide its services in Ohio.

## **Exhibit F**

### **Financial Statements of iBasis, Inc.**

Attached is a copy of the latest quarterly and annual financial statements of iBasis, Inc. as filed with the Securities and Exchange Commission. As a wholly-owned subsidiary of iBasis, Inc., iBasis Retail does not maintain separate financial statements.

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549  
**FORM 10-Q**

(Mark  
one)

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-27127

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**iBasis, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**04-3332534**

(I.R.S. Employer Identification No.)

**20 Second Avenue, Burlington, MA 01803**

(Address of principal executive offices, including zip code)

**(781) 505-7500**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether each registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☒

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐  
(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

**Common Stock, par value \$0.001 per share, as of July 31, 2009**

**71,228,328**

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**iBASIS, INC.**  
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[Table of Contents](#)**Part I—Financial Information****Item 1. Financial Statements****iBasis, Inc.****Condensed Consolidated Balance Sheets****(unaudited)**

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
	<b>(in thousands, except per share data)</b>	
<b>Assets</b>		
Cash and cash equivalents	\$ 57,342	\$ 56,912
Accounts receivable and unbilled revenue—external parties, net of allowance for doubtful accounts of \$3,136 and \$4,654, respectively	210,087	234,946
Accounts receivable—related parties	8,830	2,053
Prepaid expenses and other current assets	8,674	6,477
Total current assets	<u>284,933</u>	<u>300,388</u>
Property and equipment, net	28,316	34,836
Other assets	1,395	1,573
Intangible assets, net	77,531	87,206
Goodwill	17,324	17,324
Total assets	<u><u>\$ 409,499</u></u>	<u><u>\$ 441,327</u></u>
<b>Liabilities and Stockholders' Equity</b>		
Accounts payable—external parties	\$ 146,045	\$ 155,676
Accrued expenses	142,703	151,685
Deferred revenue	12,488	13,894
Current portion of long-term debt	636	577
Total current liabilities	<u>301,872</u>	<u>321,832</u>
Long-term debt, net of current portion	19,236	27,380
Deferred income taxes	2,331	2,534
Other long-term liabilities	894	1,063
Total liabilities	<u>324,333</u>	<u>352,809</u>
Stockholders' equity:		
Common stock, \$0.001 par value, authorized—170,000 shares and 170,000 shares, respectively; issued—76,204 and 76,204 shares; outstanding—71,228 and 71,228 shares, respectively	76	76
Additional paid-in capital	338,785	337,590
Treasury stock at cost; 4,976 and 4,976 shares, respectively	(15,000)	(15,000)
Accumulated other comprehensive loss	3	(1,140)
Accumulated deficit	(238,698)	(233,008)
Total stockholders' equity	<u>85,166</u>	<u>88,518</u>
Total liabilities and stockholders' equity	<u><u>\$ 409,499</u></u>	<u><u>\$ 441,327</u></u>

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



[Table of Contents](#)**iBasis, Inc.****Condensed Consolidated Statements of Operations****(unaudited)**

	<b>Three Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(in thousands, except per share data)</b>	
Net revenue—external parties	\$193,161	\$299,167
Net revenue—related parties	48,124	61,673
Total net revenue	<u>241,285</u>	<u>360,840</u>
Costs and operating expenses:		
Data communications and telecommunications—external parties (excluding depreciation and amortization)	192,564	297,804
Data communications and telecommunications—related parties (excluding depreciation and amortization)	16,897	25,560
Engineering and network operations expenses	4,950	6,028
Selling, general and administrative expenses	16,828	19,430
Depreciation and amortization	10,806	8,488
Total costs and operating expenses	<u>242,045</u>	<u>357,310</u>
Income (loss) from operations	(760)	3,530
Interest income	114	524
Interest expense	(440)	(554)
Foreign exchange gain (loss), net	174	(541)
Income (loss) before provision for income taxes	(912)	2,959
Provision for income taxes	3,078	2,946
Net income (loss)	<u>\$ (3,990)</u>	<u>\$ 13</u>
Net income (loss) per share:		
Basic	\$ (0.06)	\$ 0.00
Diluted	\$ (0.06)	\$ 0.00
Weighted average common shares outstanding:		
Basic	71,228	74,517
Diluted	71,228	75,072

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

[Table of Contents](#)**iBasis, Inc.****Condensed Consolidated Statements of Operations****(unaudited)**

	<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(in thousands, except per share data)</b>	
Net revenue—external parties	\$404,990	\$573,836
Net revenue—related parties	91,802	111,907
Total net revenue	<u>496,792</u>	<u>685,743</u>
Costs and operating expenses:		
Data communications and telecommunications—external parties (excluding depreciation and amortization)	401,812	564,183
Data communications and telecommunications—related parties (excluding depreciation and amortization)	32,165	48,679
Engineering and network operations expenses	9,951	12,656
Selling, general and administrative expenses	34,034	39,251
Depreciation and amortization	19,043	15,719
Total costs and operating expenses	<u>497,005</u>	<u>680,488</u>
Income (loss) from operations	(213)	5,255
Interest income	191	964
Interest expense	(1,138)	(1,437)
Foreign exchange loss, net	(389)	(792)
Income (loss) before provision for income taxes	<u>(1,549)</u>	<u>3,990</u>
Provision for income taxes	4,141	6,049
Net loss	<u>\$ (5,690)</u>	<u>\$ (2,059)</u>
Net loss per share:		
Basic	\$ (0.08)	\$ (0.03)
Diluted	\$ (0.08)	\$ (0.03)
Weighted average common shares outstanding:		
Basic	71,228	74,734
Diluted	71,228	74,734

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

[Table of Contents](#)**iBasis, Inc.****Condensed Consolidated Statements of Cash Flows****(unaudited)**

	<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>	
Cash flows from operating activities:		
Net loss	\$ (5,690)	\$ (2,059)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	19,043	15,719
Stock-based compensation	1,195	1,247
Provision for doubtful accounts receivable	873	900
Changes in assets and liabilities:		
Accounts receivable and unbilled revenue—external parties	23,986	(23,185)
Accounts receivable—related parties	3,186	(1,951)
Prepaid expenses and other current assets	(2,197)	(1,847)
Other assets	178	33
Accounts payable—external parties	(9,631)	(9,932)
Accounts payable—related parties	—	(5,798)
Accrued expenses	(8,982)	43,644
Deferred revenue	(1,406)	(655)
Long-term deferred income taxes	(204)	(236)
Other long-term liabilities	(168)	(365)
Net cash provided by operating activities	<u>20,183</u>	<u>15,515</u>
Cash flows from investing activities:		
Purchases of property and equipment	(2,777)	(6,977)
Purchase of certain assets from TDC	—	(11,050)
Maturities of available-for-sale short-term marketable investments	—	1,999
Decrease in other long-term assets	—	5,000
Net cash used in investing activities	<u>(2,777)</u>	<u>(11,028)</u>
Cash flows from financing activities:		
Bank borrowings (repayments)	(8,129)	5,000
Payment of loan from related party	(9,963)	(4,742)
Purchases of common stock	—	(4,867)
Proceeds from exercises of common stock options	—	434
Payments of principal on capital lease obligations	(327)	(1,149)
Dividend payment related to warrant exercise	—	(323)
Net cash used in financing activities	<u>(18,419)</u>	<u>(5,647)</u>
Effect of exchange rate changes on cash and cash equivalents	<u>1,443</u>	<u>(71)</u>
Net increase (decrease) in cash and cash equivalents	430	(1,231)
Cash and cash equivalents, beginning of period	<u>56,912</u>	<u>63,735</u>
Cash and cash equivalents, end of period	<u>\$ 57,342</u>	<u>\$ 62,504</u>
Supplemental disclosure of cash flow information:		
Interest paid	\$ 1,638	\$ 1,464
Taxes paid	\$ 2,338	\$ 5,958
Supplemental disclosure of non-cash investing and financing activities:		
Common stock issued in exchange for cashless warrant exercise	\$ —	\$ 192
Contribution to equity for forgiveness of costs billed by related party	\$ —	\$ 818
Contribution to equity for expenses paid directly by related party	\$ —	\$ 492
Property and equipment acquired under long-term financing arrangement	\$ 359	\$ 1,731

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



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**iBasis, Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**(1) Business and Presentation**

**Presentation**

The unaudited condensed consolidated financial statements presented herein have been prepared by us and, in the opinion of management, reflect all adjustments of a normal recurring nature necessary for a fair statement. Interim results are not necessarily indicative of results for a full year. The condensed consolidated balance sheet as of December 31, 2008 was derived from our audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, but we believe that the disclosures are adequate to make the information presented not misleading.

Balances and transactions with KPN and its other subsidiaries ("related parties") have not been eliminated, but are presented herein as balances and transactions with related parties.

**Out-of-Period Adjustments**

During the three months ended June 30, 2009, we identified immaterial errors in our consolidated financial statements for the years ended December 31, 2005 and 2008 and the three months ended March 31, 2009. These errors related to understating depreciation expense (totaling \$1.2 million in additional expense, net of tax in 2008 and \$0.6 million in additional expense, net of tax, in the three months ended March 31, 2009) and understating the valuation of foreign denominated accounts receivable (totaling \$1.7 million in an additional gain, net of tax) in 2005. As a result of these errors, net income was understated by approximately \$1.7 million in 2005 and net loss was understated by approximately \$1.2 million in 2008 and \$0.6 million in the three months ended March 31, 2009. We corrected these errors during the three months ended June 30, 2009. The combined impact to correct these errors on the three and six months ended June 30, 2009 results of operations was to increase net loss by \$0.1 million and decrease net loss by \$0.5 million, respectively. We evaluated these errors considering both qualitative and quantitative factors and considered the impact of these errors in relation to the periods in which they originated, as well as the current period, which is when they were corrected. We have concluded that these adjustments are not material to any prior periods' consolidated financial statements nor are they expected to be material to the year ending December 31, 2009.

**New Accounting Pronouncements**

In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141 (revised 2007) ("SFAS No. 141R"), "*Business Combinations*" and SFAS No. 160 ("SFAS No. 160"), "*Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51.*" SFAS No. 141R changes how business acquisitions are accounted for and impacts financial statements both on the acquisition date and in subsequent periods. SFAS No. 160 changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(1) Business and Presentation (Continued)**

and classified as a component of equity. SFAS No. 141R and SFAS No. 160 were effective beginning the first fiscal quarter of 2009. With our adoption of SFAS No. 141R on January 1, 2009, previously reserved pre-acquisition net operating losses will reduce income tax expense when utilized or when the valuation allowance for such net operating losses is released, which may have a material effect on our results operations and financial position in 2009 and in future years. Prior to January 1, 2009, the utilization of previously reserved pre-acquisition net operating losses reduced goodwill. The adoption of SFAS No. 160 on January 1, 2009 did not have a material effect on our statements of financial position, results of operations or cash flows.

In March 2008, the FASB issued SFAS No. 161 ("SFAS No. 161"), *"Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133."* The standard is intended to enhance the current disclosure framework in SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. The standard requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The adoption of SFAS No. 161 on January 1, 2009 did not have a material effect on our financial position, results of operations or cash flows.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, *"Determination of the Useful Life of Intangible Assets"* ("FSP 142-3"), FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset, under SFAS No. 142, *"Goodwill and Other Intangible Assets"* ("SFAS No. 142"). FSP 142-3 is intended to improve the consistency between the useful life of an intangible asset determined under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R and other generally accepted accounting principles. The adoption of FSP 142-3 on January 1, 2009 did not have a material effect on our financial position, results of operations or cash flows.

In May 2008, the FASB issued SFAS No. 162 ("SFAS No. 162"), *"The Hierarchy of Generally Accepted Accounting Principles."* SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles. SFAS No. 162 becomes effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *"The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles."* We do not expect that the adoption of SFAS No. 162 to have a material effect on our financial position, results of operations or cash flows.

In May 2009, the FASB issued SFAS No. 165 ("SFAS No. 165"), *Subsequent Events*, which is effective for interim or annual periods beginning after June 15, 2009. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. We have evaluated events, as defined by SFAS No. 165 through the date that the Financial Statements were issued on August 7, 2009.

In July 2009, the FASB issued SFAS No. 168 ("SFAS No. 168"), *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—A Replacement of FASB*

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(1) Business and Presentation (Continued)**

*Statement No. 162*, which is effective for interim and annual periods beginning after September 15, 2009. SFAS No. 168 will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. We do not expect the adoption of SFAS No. 168 to have a material effect on our financial position, results of operations or cash flows.

**(2) Net loss per share**

Basic and diluted net loss per common share is determined by dividing net loss by the weighted average common shares outstanding during the period.

The following table summarizes common shares that have been excluded from the computation of basic and diluted weighted average common shares for the six months ended June 30, 2009 and 2008 because their inclusion would be anti-dilutive:

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(in thousands)	
Options to purchase common shares	5,425	4,516
Warrants to purchase common shares	432	432
Total	<u>5,857</u>	<u>4,948</u>

**(3) Stock-Based Compensation**

We issue stock options as an equity incentive to employees and non-employee directors under our 2007 Stock Plan (the "2007 Plan"). The stock options we issued under our 2007 Plan are for a fixed number of shares with an exercise price equal to the fair market value of our stock on the date of grant, which is the closing price as reported on the NASDAQ Stock Market LLC. The employee stock option grants under the 2007 Plan typically vest quarterly in equal installments over four years, provided that no options shall vest during the employees' first year of employment, and have a term of ten years.

The 2007 Plan replaced the 1997 Stock Incentive Plan, which expired on August 11, 2007. All outstanding stock options granted under the 1997 Stock Incentive Plan will remain in effect until they expire according to their terms.

The Company records stock-based compensation expense in accordance with SFAS 123(R). SFAS 123(R) requires companies to recognize share-based payments to employees as compensation expense using the "fair value" method. The fair value of stock options and shares purchased pursuant to the 2007 Plan is calculated using the Black-Scholes valuation model. Under the fair value recognition provisions of SFAS 123(R), stock-based compensation, measured at the grant date based on the fair value of the award, is recognized as expense ratably over the service period.

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**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(3) Stock-Based Compensation (Continued)**

The following table presents the stock-based compensation expense included in our unaudited condensed consolidated statements of operations:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(In thousands)</b>			
Stock-based compensation expense:				
Engineering and network operations	\$152	\$167	\$ 299	\$ 312
Sales, general and administrative	457	501	896	935
Total stock-based compensation	<u>\$609</u>	<u>\$668</u>	<u>\$1,195</u>	<u>\$1,247</u>

During the three and six months ended June 30, 2009, we granted stock options totaling 11,600 shares and 1,317,100 shares, respectively, and during the three and six months ended June 30, 2008, we granted stock options totaling 18,100 shares and 1,294,150 shares, respectively. Shares granted during the six months ended June 30, 2009 and 2008 include shares granted to our directors, officers and employees. Shares granted during the three months ended June 30, 2009 and 2008 were to employees only. The fair value of these stock option awards were estimated using the Black-Scholes model with the following assumptions:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(In thousands)</b>			
Risk free interest rate	2.15%	3.17%	2.07%	2.90%
Dividend yield	0.0%	0.0%	0.0%	0.0%
Expected life	6.25 years	6.25 years	6.25 years	6.25 years
Volatility	100%	100%	100%	100%
Fair value of options granted	\$ 1.00	\$ 2.75	\$ 0.74	\$ 3.62

The risk-free interest rate was based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield of zero is based on the fact that we have no current intention to pay cash dividends. Our estimate of the expected life was based on a combination of the vesting period of four years and the term of ten years for these stock option grants. Our estimate of expected volatility is based on the historical volatility of our common stock over the period which approximates the expected life of the options.

No income tax benefit was realized from stock option exercises during the three and six months ended June 30, 2009 and 2008.

**(4) Business Segment Information**

During the three and six months ended June 30, 2009 and 2008, we operated in two business segments, Trading and Retail. Our Trading business segment includes revenue from wholesale Trading and Outsourcing. We consider Outsourcing as part of our Trading segment as the products we sell are





[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(4) Business Segment Information (Continued)**

primarily the same products that we sell to our wholesale Trading customers and Outsourcing and wholesale Trading are managed as one business. Our Retail business segment consists primarily of our prepaid calling card services and Pingo, our prepaid calling service sold directly to consumers through an Internet website.

A breakdown of our revenue and gross profit, defined as net revenue less data communications and telecommunications costs, for the three and six months ended June 30, 2009 and 2008 is as follows:

	Three Months Ended June 30, 2009		Three Months Ended June 30, 2008	
	<u>Revenue</u>	<u>Gross Profit</u>	<u>Revenue</u>	<u>Gross Profit</u>
	(In millions)			
Trading	\$166.2	\$ 19.7	\$272.1	\$ 23.7
Outsourcing	54.2	8.8	67.8	11.0
Retail	20.9	3.3	20.9	2.8
Total	<u>\$241.3</u>	<u>\$ 31.8</u>	<u>\$360.8</u>	<u>\$ 37.5</u>

	Six Months Ended June 30, 2009		Six Months Ended June 30, 2008	
	<u>Revenue</u>	<u>Gross Profit</u>	<u>Revenue</u>	<u>Gross Profit</u>
	(In millions)			
Trading	\$349.5	\$ 39.5	\$526.2	\$ 45.4
Outsourcing	102.2	16.3	118.0	21.2
Retail	45.1	7.0	41.5	6.3
Total	<u>\$496.8</u>	<u>\$ 62.8</u>	<u>\$685.7</u>	<u>\$ 72.9</u>

We use net revenue and gross profit, which is net revenue less data communications and telecommunications costs, as the basis for measuring profit or loss and making decisions on our Trading and Retail business segments. We do not allocate our engineering and network operations expenses, selling, general and administrative expenses, and depreciation and amortization between Trading and Retail.

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(4) Business Segment Information (Continued)**

Operating results, excluding interest income and expense, foreign exchange gains or losses, and income tax expense, for our two business segments are as follows:

	<b>Three Months Ended June 30, 2009</b>		
	<b>Trading</b>	<b>Retail</b>	<b>Total</b>
	<b>(In thousands)</b>		
Net revenue—external parties	\$172,244	\$20,917	\$193,161
Net revenue—related parties	48,124	—	48,124
Total net revenue	220,368	20,917	241,285
Data communications and telecommunication costs—external parties	174,996	17,568	192,564
Data communications and telecommunication costs—related parties	16,897	—	16,897
Total data communications and telecommunications	191,893	17,568	209,461
Gross profit	<u>\$ 28,475</u>	<u>\$ 3,349</u>	31,824
Engineering and network operations expenses			4,950
Selling, general and administrative expenses			16,828
Depreciation and amortization			10,806
Loss from operations			<u>\$ (760)</u>

	<b>Three Months Ended June 30, 2008</b>		
	<b>Trading</b>	<b>Retail</b>	<b>Total</b>
	<b>(In thousands)</b>		
Net revenue—external parties	\$278,295	\$20,872	\$299,167
Net revenue—related parties	61,673	—	61,673
Total net revenue	339,968	20,872	360,840
Data communications and telecommunication costs—external parties	279,732	18,072	297,804
Data communications and telecommunication costs—related parties	25,560	—	25,560
Total data communications and telecommunications	305,292	18,072	323,364
Gross profit	<u>\$ 34,676</u>	<u>\$ 2,800</u>	37,476
Engineering and network operations expenses			6,028
Selling, general and administrative expenses			19,430
Depreciation and amortization			8,488
Income from operations			<u>\$ 3,530</u>

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(4) Business Segment Information (Continued)**

	<b>Six Months Ended June 30, 2009</b>		
	<b>Trading</b>	<b>Retail</b>	<b>Total</b>
	<b>(In thousands)</b>		
Net revenue—external parties	\$359,875	\$45,115	\$404,990
Net revenue—related parties	91,802	—	91,802
Total net revenue	451,677	45,115	496,792
Data communications and telecommunication costs—external parties	363,715	38,097	401,812
Data communications and telecommunication costs—related parties	32,165	—	32,165
Total data communications and telecommunications	395,880	38,097	433,977
Gross profit	<u>\$ 55,797</u>	<u>\$ 7,018</u>	62,815
Engineering and network operations expenses			9,951
Selling, general and administrative expenses			34,034
Depreciation and amortization			19,043
Loss from operations			<u>\$ (213)</u>

	<b>Six Months Ended June 30, 2008</b>		
	<b>Trading</b>	<b>Retail</b>	<b>Total</b>
	<b>(In thousands)</b>		
Net revenue—external parties	\$532,391	\$41,445	\$573,836
Net revenue—related parties	111,907	—	111,907
Total net revenue	644,298	41,445	685,743
Data communications and telecommunication costs—external parties	529,019	35,164	564,183
Data communications and telecommunication costs—related parties	48,679	—	48,679
Total data communications and telecommunications	577,698	35,164	612,862
Gross profit	<u>\$ 66,600</u>	<u>\$ 6,281</u>	72,881
Engineering and network operations expenses			12,656
Selling, general and administrative expenses			39,251
Depreciation and amortization			15,719
Income from operations			<u>\$ 5,255</u>

Assets relating to our Trading and Retail business segments consist of accounts receivable, net of allowance for doubtful accounts, customer and distributor relationships intangible assets and goodwill.

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(4) Business Segment Information (Continued)**

We do not allocate cash and cash equivalents, prepaid expenses and other current assets, property and equipment, net, or other assets between Trading and Retail.

	<b>As of June 30, 2009</b>		
	<b>Trading</b>	<b>Retail</b>	<b>Total</b>
	<b>(In thousands)</b>		
<i>Segment assets:</i>			
Accounts receivable and unbilled revenue—external parties, net	\$204,005	\$ 6,082	\$210,087
Intangible assets—customer and distributor relationships, net	23,123	8,726	31,849
Goodwill	17,324	—	17,324
	<u>\$244,452</u>	<u>\$14,808</u>	<u>259,260</u>
Non-segment assets			<u>150,239</u>
Total assets			<u><u>\$409,499</u></u>

	<b>As of December 31, 2008</b>		
	<b>Trading</b>	<b>Retail</b>	<b>Total</b>
	<b>(In thousands)</b>		
<i>Segment assets:</i>			
Accounts receivable and unbilled revenue—external parties, net	\$224,883	\$10,063	\$234,946
Intangible assets—customer and distributor relationships, net	26,147	10,420	36,567
Goodwill	17,324	—	17,324
	<u>\$268,354</u>	<u>\$20,483</u>	<u>288,837</u>
Non-segment assets			<u>152,490</u>
Total assets			<u><u>\$441,327</u></u>

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(5) Accounts Receivable and Unbilled Revenue—External Parties**

Accounts receivable—external parties, net consists of the following:

	<u>As of June 30, 2009</u>	<u>As of December 31, 2008</u>
	(In thousands)	
Accounts receivable	\$ 202,233	\$ 183,239
Unbilled revenue	10,990	56,361
	<u>213,223</u>	<u>239,600</u>
Allowance for doubtful accounts	(3,136)	(4,654)
Total accounts receivable—external parties	<u>\$ 210,087</u>	<u>\$ 234,946</u>

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on specific known uncollectible accounts, historical experience, and other currently available evidence. During the six months ended June 30, 2009, we wrote-off \$2.4 million of previously reserved accounts receivable to the allowance for doubtful accounts. The balance of the allowance for doubtful accounts as of December 31, 2008 has been adjusted to reflect the current period classification of the components of the allowance.

**(6) Property and Equipment**

Property and equipment, net, consists of the following:

	<u>As of June 30, 2009</u>	<u>As of December 31, 2008</u>
	(In thousands)	
Network equipment	\$ 44,463	\$ 44,332
Software	16,091	17,538
Leasehold improvements	1,414	1,629
Other tangible fixed assets	3,378	3,594
	<u>65,346</u>	<u>67,093</u>
Accumulated depreciation	(37,030)	(32,257)
Total property and equipment, net	<u>\$ 28,316</u>	<u>\$ 34,836</u>

Total depreciation and amortization expense related to property and equipment was \$6.0 million and \$4.2 million for the three months ended June 30, 2009 and 2008, respectively, and \$9.4 million and \$7.6 million for the six months ended June 30, 2009 and 2008, respectively.

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**iBasis, Inc.**
**Notes to Condensed Consolidated Financial Statements (Continued)**
**(unaudited)**
**(7) Goodwill and Other Intangible Assets**

Other intangible assets, net consisted of the following:

	<u>As of June 30, 2009</u>		<u>As of December 31, 2008</u>	
	<u>At Cost</u>	<u>Accumulated Amortization</u>	<u>At Cost</u>	<u>Accumulated Amortization</u>
	<u>(In thousands)</u>			
Trademarks and trade names	\$ 21,800	\$ (2,544)	\$ 21,800	\$ (1,817)
Wholesale customer relationships	30,747	(7,616)	30,747	(4,616)
Retail distributor relationships	13,500	(4,779)	13,500	(3,080)
Termination partner relationships	8,400	(3,637)	8,400	(2,719)
Technology	33,300	(11,656)	33,300	(8,325)
Other	64	( 48)	64	( 48)
	<u>\$107,811</u>	<u>\$ (30,280)</u>	<u>\$107,811</u>	<u>\$ (20,605)</u>

We currently expect to amortize the following remaining amounts of intangible assets as of June 30, 2009 in the fiscal periods as follows:

<u>Year ending December 31,</u>	<u>(In thousands)</u>
2009 (remaining six months)	\$ 9,691
2010	17,916
2011	16,382
2012	12,517
2013	3,875
Thereafter	17,150
Total	<u>\$ 77,531</u>

**Impairment**

We have two operating segments which are also our reporting units: (1) Trading and (2) Retail. As of June 30, 2009 and December 31, 2008, all goodwill was assigned to our Trading reporting unit.

At each year-end we perform an annual impairment test of goodwill as required under the provisions of SFAS 142 and whenever events or changes in circumstances would more likely than not reduce the fair value of a reporting unit below its carrying value. SFAS No. 142 requires that the impairment test be performed through the application of a two-step process. The first step compares the carrying value of our reporting units, which are our Trading and Retail operating segments, to their estimated fair values as of the test date. If fair value is less than carrying value, a second step must be performed to quantify the amount of the impairment, if any. We estimate the fair value of our reporting units using an income approach, as of December 31, 2008, which estimates fair value based upon future cash flows discounted to their present value. We then reconcile the estimated fair value of our reporting units to our overall market capitalization. Assessing the impairment of goodwill requires us to make certain significant assumptions, estimates and judgments, including future revenue, expenses, cash flows, discount rates and implied control premiums. The actual results may differ from

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(7) Goodwill and Other Intangible Assets (Continued)**

these assumptions and estimates and it is possible that such differences could have a material impact on our financial statements.

We base the valuation of our Trading reporting unit, in part, on i) our actual historical performance; ii) our estimate of the future performance of our Trading reporting unit and iii) projections developed by an independent analyst. As a result of our annual impairment analysis as of December 31, 2008, we concluded there had been an impairment of the carrying value of goodwill of \$214.7 million as of December 31, 2008. In addition, the carrying value of goodwill was further reduced by \$16.8 million, to \$17.3 million, as of December 31, 2008, as a result of the utilization of previously reserved pre-acquisition net operating losses.

For intangible assets, we assess the carrying value of these assets whenever events or circumstances indicate that the carrying value may not be recoverable. We determined that the adverse business climate and the significant drop in our market capitalization experienced during the fourth quarter of fiscal 2008 were significant events that indicated that the carrying amount of our intangible assets might not be recoverable. SFAS No. 144 requires a two-step test to be performed prior to assessing the impairment of goodwill. The first step compares the carrying value of the asset, or asset group, to the undiscounted cash flows of the asset, or asset group. If the asset or asset group's carrying value exceeds the undiscounted cash flows, step two of the test is required to measure the impairment loss, if any. An asset or asset group cannot be impaired below the asset or asset group's fair value.

As required by SFAS No. 144, we performed our assessment, as of December 31, 2008, at the asset group level which represented the lowest level of cash flows that are largely independent of cash flows of other assets and liabilities. For us, this asset grouping is at the reporting unit level. When performing this test at the reporting unit level, goodwill is included in the carrying value of the asset group. The carrying value of the Trading reporting unit, including goodwill (prior to the goodwill impairment charge described above), was greater than the undiscounted cash flows while the Retail reporting unit's undiscounted cash flows exceeded the carrying value. For our Trading reporting unit, we performed step two of the impairment test and determined there was no impairment of our intangible assets as the fair value of the asset group, excluding goodwill, was greater than the carrying value. The projections and assumptions used in calculating the fair value of the assets were consistent with the projections used in the goodwill impairment test as of December 31, 2008. We also reassessed the amortization method and remaining amortization period for the assets, as of December 31, 2008, and determined that no changes to the amortization period or method were necessary.

During the three months ended March 31, 2009, our market capitalization continued to decline. As a result, we considered this to be an indication that the carrying value of \$17.3 million of our goodwill may be impaired. Accordingly, we conducted an analysis to determine if there had been an impairment of the carrying value of goodwill as of March 31, 2009. Our analysis was performed in accordance with SFAS 142, as described above. As a result of this analysis, we determined that the carrying value of goodwill was not impaired as of March 31, 2009. In addition, we performed an analysis under SFAS 144 of our other intangible assets and determined that the carrying value of our other intangible assets was not impaired as of March 31, 2009.

During the three months ended June 30, 2009, our market capitalization increased to approximately \$93.3 million. In addition, the financial performance of our Trading reporting unit for



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**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(7) Goodwill and Other Intangible Assets (Continued)**

the six months ended June 30, 2009 approximated our prior financial projections for this period. As our market capitalization was in excess of the book value of our Trading reporting unit as of June 30, 2009 and the financial performance of our Trading reporting unit had met our prior expectations, we determined that the carrying value of goodwill was not impaired as of June 30, 2009. It is reasonably possible that there could be an impairment of our intangible assets and/or our remaining goodwill in the near term and the amounts could be material.

**(8) Accrued Expenses**

Accrued expenses consist of the following:

	As of June 30, 2009	As of December 31, 2008
	(In thousands)	
Termination fees and circuit costs	\$ 116,719	\$ 136,655
Compensation	4,128	3,224
Dividend payable	1,421	1,421
Accrued other	20,435	10,385
Total accrued expenses	<u>\$ 142,703</u>	<u>\$ 151,685</u>

**(9) Accrued Restructuring Costs**

At June 30, 2009, we had accrued restructuring costs of \$0.7 million, which consisted of \$0.4 million in future payment obligations relating to a terminated New York City facility lease and \$0.3 million of costs accrued for future lease obligations for certain vacant leased facilities, net of future sublease payments. Payments of these restructuring costs will be made through February 2011.

A summary of accrued restructuring costs for the six months ended June 30, 2009 is as follows:

	Future Payment Obligation on Lease Termination	Contractual Lease Obligations Relating to Vacant Facilities (In thousands)	Total
Balance, December 31, 2008	\$ 490	\$ 611	\$1,101
Cash payments	(117)	(259)	(376)
Balance, June 30, 2009	<u>\$ 373</u>	<u>\$ 352</u>	<u>\$ 725</u>
Current portion, included in accrued expenses			\$ 580
Long-term portion, included in other long-term liabilities			145
Total			<u>\$ 725</u>

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(10) Income Taxes**

The income tax provision of \$3.1 million and \$2.9 million for the three months ended June 30, 2009 and 2008, respectively, and \$4.1 million and \$6.0 million for the six months ended June 30, 2009 and 2008, respectively, primarily relates to income taxes on the taxable income of our Netherlands operations. For the six months ended June 30, 2009 compared to the six months ended June 30, 2008, the lower income tax provision was largely a result of our integration efforts, which have increased the level of management and support of our Netherlands operations that is being provided from our U.S. headquarters. As a result, we have been able to reduce the pre-tax income of our Netherlands operations and, correspondingly, we have reduced the level of losses in the U.S. for which we receive no current tax benefit.

As discussed in Note 10 to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008, we have recorded a valuation allowance against our U.S. net deferred tax assets since it is more likely than not that our U.S. net deferred tax assets will not be realized. With our adoption of SFAS No. 141R on January 1, 2009, previously reserved pre-acquisition net operating losses will reduce income tax expense when utilized or when the valuation allowance for such net operating losses is released.

**(11) Line of Credit and Long-Term Debt**

Long-term debt consists of the following:

	As of June 30, 2009	As of December 31, 2008
	(In thousands)	
Bank borrowings	\$ 18,951	\$ 27,080
Capital lease obligations	921	877
	19,872	27,957
Less: Current portion	(636)	(577)
Long-term portion	<u>\$ 19,236</u>	<u>\$ 27,380</u>

In October 2007, we entered into a Second Amended and Restated Loan and Security Agreement (the "Loan Agreement") with Silicon Valley Bank, which amended and restated a certain Amended and Restated Loan and Security Agreement dated as of December 29, 2003. We entered into the Loan Agreement to obtain funding for working capital purposes and in support of the KPN Transaction. Pursuant to the Loan Agreement, as subsequently amended, we may borrow up to \$35.0 million from time to time under a secured revolving credit facility through September 30, 2010. Borrowings under the line of credit will be on a formula basis, based on eligible domestic and foreign accounts receivable. The line of credit contains quarterly financial covenants, consisting primarily of minimum profitability and minimum liquidity requirements. The line of credit has a quarterly commitment fee of 0.63% on any unused portion of the line of credit and an up-front, one-time facility fee of 0.75%, or \$263,000. The revolving credit facility is also guaranteed by all domestic wholly-owned subsidiaries. The revolving credit facility is collateralized by a first priority lien and security interest on the assets of iBasis and such guarantors. In addition, iBasis has pledged 66.2% of all of its ownership in iBasis Netherlands B.V., a wholly-owned subsidiary based in The Netherlands, as collateral for the revolving

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(11) Line of Credit and Long-Term Debt (Continued)**

credit facility. Pursuant to the terms of the Loan Agreement, we may use the proceeds solely for working capital and to fund our general business requirements.

In April and September 2008, we modified the Loan Agreement, which modifications were subsequently superseded by a more recent modification. On January 26, 2009, we entered into the Third Loan Modification Agreement with Silicon Valley Bank, effective as of December 30, 2008. The modification to the Loan Agreement contains the following amendments, among others:

- i) We decreased the amount available under the Loan Agreement from \$50.0 million to \$35.0 million;
- ii) We extended the maturity date of the Loan Agreement to September 30, 2010;
- iii) We established minimum interest rates payable on amounts drawn under the Loan Agreement, which include an interest rate floor of 4.25% on amounts subject to Silicon Valley Bank's prime rate and an interest rate floor of 2.0% on amounts subject to the LIBOR rate;
- iv) We changed formulas for determining quarterly adjustments to margins applicable to prime rate and LIBOR rate and formula for unused revolving line fee from formulas based on the total funded debt ratio to formulas based on EBITDA (earnings before interest, taxes, depreciation and amortization) minus capital expenditures;
- v) We increased the frequency of certain financial reporting requirements from quarterly to monthly as requested by Silicon Valley Bank;
- vi) We modified the minimum adjusted quick ratio financial covenant to require a minimum adjusted quick ratio of 0.80 to 1.00 for the fiscal quarter ended December 31, 2008 and as of the end of each fiscal quarter thereafter;
- vii) We deleted the minimum consolidated EBITDA financial covenant;
- viii) We added a financial covenant requiring consolidated EBITDA minus capital expenditures to be at least (a) a loss of \$1,000,000 with respect to the fiscal quarters ending December 31, 2008 and March 31, 2009, (b) \$1.00 with respect to the fiscal quarter ending June 30, 2009, (c) \$1,750,000 with respect to the fiscal quarter ending September 30, 2009, and (d) \$3,500,000 with respect to the fiscal quarter ending December 31, 2009 and each fiscal quarter thereafter; and
- ix) We modified the minimum liquidity financial covenant to require a new minimum liquidity amount of \$17.5 million measured at the end of each fiscal month through August 31, 2009 and a minimum of \$20 million at the end of each fiscal month thereafter. In addition, we are required to maintain at least 40% of our total cash, cash equivalents and short-term investments with Silicon Valley Bank.

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**iBasis, Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(unaudited)**

**(11) Line of Credit and Long-Term Debt (Continued)**

In connection with this modification, we paid Silicon Valley Bank a modification fee of \$52,500 and a revolving line renewal fee of \$175,000 which are being recognized as interest expense.

At June 30, 2009 and December 31, 2008, we had \$19.0 million and \$27.1 million, respectively, in borrowings outstanding, and had issued outstanding standby letters of credit of \$2.5 million and \$2.6 million, respectively, under the Loan Agreement. As of June 30, 2009, we were in compliance with all of the covenants under the Loan Agreement.

In the six months ended June 30, 2009, we purchased certain equipment for \$0.4 million under a four year financing agreement, with payments due monthly through May 2013.

**(12) Commitments and Contingencies**

***Commitments***

We lease our administrative and operating facilities, under operating leases which expire on various dates through 2018. The future approximate minimum lease payments under these operating leases as of June 30, 2009 consist of the following:

	<u>(in thousands)</u>
Less than one year	\$ 2,496
One to two years	1,137
Two to three years	855
Three to four years	830
Four to five years	379
Thereafter	1,361
Total future minimum lease payments	<u>\$ 7,058</u>

At June 30, 2009, we had commitments with certain telecommunications carriers for the termination of minutes for the next twelve months totaling \$35.6 million. As of June 30, 2009, we did not have any other material purchase obligations, or other material long-term commitments reflected on our consolidated balance sheets.

***Litigation***

In addition to litigation that we have initiated or responded to in the ordinary course of business, we are currently party to the following potentially material legal proceedings:

***Complaint Filed Against Royal KPN and Affiliates Relating to Unsolicited Tender Offer by KPN***

For a description of the complaint the Company filed against Royal KPN and its affiliates in August 2009 relating to the unsolicited tender offer by KPN, please see the legal proceedings described under the heading "Tender Offer by Royal KPN" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," contained in this Quarterly Report on Form 10-Q.



[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(12) Commitments and Contingencies (Continued)***Class Action Pursuant to 1999 Initial Public Offering*

In 2001, we were served with several class action complaints that were filed in the United States District Court for the Southern District of New York against us and several of our officers, directors, and former officers and directors, as well as against the investment banking firms that underwrote our November 10, 1999 initial public offering of common stock and our March 9, 2000 secondary offering of common stock. The complaints were filed on behalf of a class of persons who purchased our common stock between November 10, 1999 and December 6, 2000.

The complaints are similar to each other and to hundreds of other complaints filed against other issuers and their underwriters, and allege violations of the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), primarily based on the assertion that there was undisclosed compensation received by our underwriters in connection with our public offerings and that there were understandings with customers to make purchases in the aftermarket.

In September 2001, the complaints were consolidated and allege that our prospectuses failed to disclose these arrangements. The consolidated complaint seeks an unspecified amount of monetary damages and other relief. In October 2002, the individual defendants were dismissed from the litigation by stipulation and without prejudice and subject to an agreement to toll the running of time-based defenses. In February 2003, the district court denied our motion to dismiss.

In June 2004, we and the individual defendants, as well as many other issuers named as defendants in the class action proceeding, entered into an agreement-in-principle to settle this matter, and this settlement was presented to the court. The district court granted a preliminary approval of the settlement in February 2005, subject to certain modifications to the proposed bar order, to which plaintiffs and issuers agreed. In August 2005, the district court issued a preliminary order further approving the modifications to the settlement, certifying the settlement classes and scheduled a fairness hearing, after notice to the class. Plaintiffs have continued to pursue their claims against the underwriters. The district court established a procedure whereby six "focus" cases are being pursued initially and has certified a class of purchasers in those cases. The underwriters appealed the certification order in each of the six cases and in December 2006, the United States Court of Appeals for the Second Circuit reversed the certification orders. Motions to dismiss amended complaints filed in the six focus cases have been denied.

The plaintiffs, the underwriter defendants, the issuer defendants and the issuer's insurers have entered into preliminary settlement agreements, subject to approval of the district court. The district court issued a Preliminary Approval Order on June 11, 2009 and scheduled the Settlement Fairness Hearing for September 10, 2009. The proposed settlement would release all of the claims asserted against us and would be funded by the underwriter defendants and the issuers' insurers. There can be no assurance that the proposed settlement will be approved by the district court.. We believe that if this matter is not settled, we have meritorious defenses which we intend to vigorously assert. We cannot estimate potential losses, if any, from these matters or whether, in light of our insurance coverage, any loss would be material to our financial condition, results of operations or cash flows. As such, no amounts have been accrued as of June 30, 2009.

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(12) Commitments and Contingencies (Continued)***SEC Option Investigation*

We announced on October 20, 2006, that we were contacted by the SEC as part of an informal inquiry and we further disclosed on March 29, 2007, in our Current Report on Form 8-K, that the SEC had notified us that we would be receiving a formal order of investigation relating to our stock option practices. On April 13, 2007, we received the formal order of investigation. The SEC investigation sought documents and information from us relating to the grant of our options from 1999 through 2006. The SEC has taken testimony from individuals including certain of our current and former officers and directors. We have cooperated fully with the SEC investigation and we are in communication with the SEC staff regarding the outcome of the investigation. There is no assurance that we will be able to resolve the SEC investigation on acceptable terms without the institution of enforcement proceedings by the SEC against us or one or more of our senior executive officers or that other inquiries will not be commenced by other U.S. federal, state or other regulatory agencies. An SEC enforcement proceeding could seek an injunction against future violations of the securities laws, a civil penalty and, as to individual executives, disgorgement and a bar order against serving as an officer or director of a publicly traded company. A bar order as to any of our senior executive officers would deprive us of any such executive's services and could have a material adverse affect on our business.

We cannot estimate the amount of losses, if any, from the SEC investigation, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amounts have been accrued as of June 30, 2009.

*Sub-Distributor Action*

On September 20, 2007, J & J Communications ("J & J"), a sub-distributor of calling cards distributed through iBasis distributor Abdul Communications ("Abdul"), amended a complaint filed in the United States District Court for the District of Maryland against Abdul, to add iBasis and PCI, a wholesale calling-card provider ("PCI"), as defendants in the matter. The complaint asserts that J & J has lost and continues to lose money because iBasis and PCI deactivated calling cards for which J & J allegedly paid. J & J is seeking in excess of \$1.0 million, plus punitive damages, attorneys fees and litigation costs based on a variety of claims against Abdul, iBasis, and PCI, predicated on contractual theories, various torts, conspiracy and an alleged violation of § 201 of the Telecommunications Act. With respect to iBasis, J & J alleges both direct liability and vicarious liability, for its alleged status as principal in an alleged agency relationship with Abdul. iBasis responded to the amended complaint through an answer and motion to dismiss on February 8, 2008. On June 2, 2008, the Court dismissed the conspiracy and Telecommunications Act claims.

Mandated mediation took place on May 28, 2009 but failed to result in any settlement. Fact discovery has been completed and the Plaintiff filed a damages expert report on July 14, 2009. On July 17<sup>th</sup>, 2009, Defendants filed a joint motion to modify the schedule and stay expert discovery pending the resolution of summary judgment motions ("Joint Motion"). In the Joint Motion, the Defendants requested that the Court require summary judgment motions to be filed by August 27<sup>th</sup>. The Joint Motion is pending with the Court. If J&J's claims survive motions to dismiss, a trial would commence in the three months ended December 31, 2009 or the three months ended March 31, 2010.

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(12) Commitments and Contingencies (Continued)**

We cannot estimate the amount of losses, if any, from this matter, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amount has been accrued as of June 30, 2009.

*Bankruptcy Preference Claim*

On April 24, 2001 (the "Petition Date"), World Access, Inc. ("World Access"), WorldxChange Communications, Inc. ("WorldxChange"), and Facicom International, LLC ("Facicom"), together with other related debtors (collectively, the "Debtors"), filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Northern District of Illinois (Eastern Division). The Debtors' cases are jointly administered but have not been substantively consolidated. Prior to the Petition Date, we and the Debtors engaged in a reciprocal business relationship. On or about April 21, 2003 the Debtors initiated a large number of avoidance actions, including an adversary proceeding in which the Debtors asserted claims against us for allegedly preferential transfers and nonpayment of overdue amounts owed by iBasis to the Debtors totaling approximately \$2.1 million. We have asserted defenses to the claims, invoked statutory defenses and filed proofs of claim for approximately \$0.5 million to which the trustee for the Debtors has objected. In July 2009, we entered into a settlement agreement with the Debtors pursuant to which we will pay \$0.5 million in full payment of all claims. We made this payment in early August 2009. As of June 30, 2009, we had accrued \$0.5 million for this claim.

*Consumer Class Action*

We were named in a putative consumer class action complaint, filed in the United States District Court for the District of New Jersey. We were served on May 27, 2008. The putative class action plaintiff, Orlando Ramirez, asserted violations of consumer protection statutes in New Jersey and other states on behalf of an asserted nationwide class of purchasers due to an alleged failure to adequately disclose the actual calling time available on iBasis' prepaid calling cards. We filed a motion to change venue to the Eastern District of New York where named plaintiff resides and purchased the card. Plaintiffs were granted a voluntary dismissal, without prejudice, on July 9, 2008. On December 19, 2008, a substantially similar complaint was filed against us on behalf of Mr. Ramirez in the United States District Court for the Eastern District of New York. We were served with the summons and complaint on April 16, 2009. On June 30, 2009, we filed a motion in the Eastern District to require plaintiffs to pay our attorneys fees and costs incurred in connection with plaintiff's prior filing in the District of New Jersey. Oral argument on the motion has been set for August 11, 2009. We believe that we have substantial defenses to the claims alleged in the complaint and we intend to vigorously defend against the claims asserted. We cannot estimate the amount of losses, if any, from this matter, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amount has been accrued as of June 30, 2009.

*Other Matters*

We are also subject to suits for collection, related commercial disputes, claims by former employees, garnishment actions, claims related to certain taxes, claims from carriers and foreign service partners over reconciliation of payments for circuits, Internet bandwidth and/or access to the public



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**iBasis, Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(unaudited)**

**(12) Commitments and Contingencies (Continued)**

switched telephone network, and claims from estates of bankrupt companies alleging that we received preferential payments from such companies prior to their bankruptcy filings. We cannot estimate the amount of losses, if any, from these matters, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amount has been accrued as of June 30, 2009.

**(13) Related Party Transactions**

***Revenue and Data and Telecommunication Costs***

Revenue from KPN and its subsidiaries amounted to \$48.1 million and \$61.7 million for the three months ended June 30, 2009 and 2008, respectively, and \$91.8 million and \$111.9 million for the six months ended June 30, 2009 and 2008, respectively, and is reported in net revenue from related parties in the Condensed Consolidated Statements of Operations.

Data and telecommunication costs purchased from KPN was \$14.2 million and \$25.6 million for the three months ended June 30, 2009 and 2008, respectively, and \$29.5 million and \$48.7 million for the six months ended June 30, 2009 and 2008, respectively, and is reported in data and telecommunications costs—related parties in the Condensed Consolidated Statements of Operations. These costs relate to services for the procurement and transmission of sending and receiving traffic (provided to us by KPN and its subsidiaries).

***Allocated expenses***

Engineering and network operations expenses include allocated costs from KPN, which were \$0.9 million and \$1.7 million for the three months ended June 30, 2009 and 2008, respectively, and \$2.1 million and \$3.5 million for the six months ended June 30, 2009 and 2008, respectively. The reduction in engineering and network operations support from KPN reflects the results of our integration efforts and the migration of our mid-range voice product to our VoIP network.

Selling, general and administrative expenses include allocated corporate and divisional costs from KPN, which were \$0.8 million and \$0.9 million for the three months ended June 30, 2009 and 2008, respectively, and \$1.5 million and \$2.0 million for the six months ended June 30, 2009 and 2008, respectively. The decrease in these allocated costs from KPN primarily reflects certain costs that were previously allocated, such as audit fees, which are now being paid directly by us, as well as the result of the integration of our Netherlands and U.S. operations.

***Working Capital and Debt Adjustments related to KPN Transaction***

In accordance with the Share Purchase Agreement for the KPN Transaction, a post-closing adjustment was required if (i) iBasis' working capital was lower than or exceeded \$37.1 million; (ii) iBasis' debt exceeded or was lower than \$2.9 million; (iii) the combined working capital of KPN GCS was lower than or exceeded \$(6.1) million; and/or (iv) the combined debt of KPN GCS exceeded \$0, as of the date of the closing of the KPN Transaction. Based on iBasis' balance sheet position on the date of the closing of the KPN Transaction, working capital was \$3.4 million less than the specified level of \$37.1 million, and debt was \$1.8 million less than the specified level of \$2.9 million. As a result, a payment of \$11.6 million was due to KPN from iBasis. Based on KPN GCS's balance sheet position



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**iBasis, Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(unaudited)**

**(13) Related Party Transactions (Continued)**

on the date of the closing of the KPN Transaction, working capital exceeded the specified level of \$(6.1) million by \$3.9 million and debt was at the specified level of \$0. As a result, payment of \$3.9 million was due to KPN from iBasis.

In early 2008, KPN forgave \$0.8 million in expenses incurred by KPN GCS since the closing of the KPN Transaction. As a result, the amount due to KPN was reduced by this amount and the reduction was recorded as a contribution to equity. These expenses were recorded in our results of operations in the three months ended March 31, 2008. The total amount of \$14.7 million due to KPN was scheduled to be paid by iBasis in three successive quarterly installments through the third quarter of 2008, with interest at the rate of 6% per annum. In May 2008, we made the first payment of \$5.2 million, including interest, to KPN. In September 2008, we revised the terms of the remaining balance of \$10.3 million due to KPN to extend the payment date of the second installment payment to March 2009 and the final installment to June 2009. In addition, the interest rate was increased to 7% on the principal amount due, effective October 1, 2008, and we paid additional interest of \$60,000 relating to the extension of the second installment that was originally due June 30, 2008. In March 2009, we made the second installment payment of \$5.5 million, including interest, and in June 2009, we made the third and final installment payment of \$5.2 million, including interest, to KPN.

**Tender Offer by Royal KPN**

On July 13, 2009, the Company's Board of Directors received a letter from Royal KPN stating its intention to commence a tender offer, through its subsidiary KPN (the "Purchaser"), to acquire all of the shares of the Company's common stock not owned by KPN at an offer price of \$1.55 per share in cash (the "Offer"). On July 15, 2009, the Board of Directors of the Company unanimously approved the creation of a special committee (the "Special Committee"), composed of W. Frank King (Chairman), Charles N. Corfield and Robert H. Brumley, to evaluate the Offer and make a recommendation to the stockholders of the Company. On July 28, 2009, the Purchaser commenced the Offer and described the terms of the Offer in a Tender Offer Statement filed with the SEC under cover of Schedule TO. On July 30, 2009, the Company, acting through the Special Committee, responded to the Offer by filing under Schedule 14D-9, which contained the unanimous recommendation of the Special Committee that the Company's stockholders reject the Offer and not tender their shares pursuant to the Offer, because the tender offer price of \$1.55 per share was grossly inadequate, opportunistic and not in the best interests of the Company's shareholders.

On July 30, 2009, the Board of Directors approved the adoption of a limited duration shareholder rights plan. The rights plan was implemented through the Company's entry into a rights agreement with Computershare Trust Company, N.A., as rights agent, and the declaration of a non-taxable dividend distribution of one preferred stock purchase right (each, a "Right") for each outstanding share of the Company's common stock. The dividend is payable on August 10, 2009 to holders of record as of the close of business on August 10, 2009. Each right is attached to and trades with the associated share of common stock. The rights will become exercisable only if a person acquires beneficial ownership of 15% or more of the Company's common stock (or, in the case of a person who beneficially owned 15% or more of the Company's common stock on the date the rights plan was adopted, such person acquires beneficial ownership of any additional shares of the Company's common stock) or after the date of the Rights Agreement, commences a tender offer that, if consummated, would result in

[Table of Contents](#)**iBasis, Inc.****Notes to Condensed Consolidated Financial Statements (Continued)****(unaudited)****(13) Related Party Transactions (Continued)**

beneficial ownership by a person of 15% or more of the Company's common stock. The rights will expire on July 30, 2010, unless the rights are earlier redeemed or exchanged. A copy of the rights agreement was filed with the SEC on July 30, 2009 as Exhibit 4.1 to the Company's Current Report on Form 8-K.

On August 3, 2009, the Company filed a lawsuit in the Court of Chancery in the State of Delaware, against Royal KPN, Purchaser, other KPN entities and certain members of KPN's management and Supervisory Board (collectively, the "Defendants") with respect to the Offer. The complaint asserts: several counts for breaches of fiduciary duty against certain of the Defendants, aiding and abetting the breaches of fiduciary duty against certain of the Defendants, civil conspiracy against all Defendants, and fraudulent inducement against certain of the Defendants. The complaint seeks, among other relief, to enjoin the Offer.

As a result of the commencement of the Offer by KPN and our filing of the complaint against the Defendants, we expect to incur significant expenses during the three months ended September 30, 2009, primarily for legal and investment banking consultation to the Company's Special Committee and Board of Directors.

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

**Overview**

We are a leading wholesale carrier of international long distance telephone calls and a provider of retail prepaid calling services and enhanced services for mobile operators.

Our operations consist of our wholesale trading business ("Trading"), in which we connect buyers and sellers of international telecommunications services, and our retail services business ("Retail"). Our Trading business also includes outsourcing revenue ("Outsourcing") which we generate as a managed services provider of wholesale international voice services for certain carrier customers, including KPN B.V. ("KPN") which owns a majority of our outstanding common stock.

In our Trading business we receive voice traffic from buyers—originating telecommunications carriers who are interconnected to our network via Voice over Internet Protocol ("VoIP") or traditional time division multiplexing ("TDM") connections, and we route that traffic over our network to sellers—local service providers and telecommunications carriers in the destination countries with whom we have established agreements to manage the completion or termination of calls. We offer our Trading service on a wholesale basis to carriers, mobile operators, consumer VoIP companies, telephony resellers and other service providers worldwide. Our Outsourcing revenue currently consists of international voice traffic we terminate for Royal KPN N.V. ("Royal KPN") and its affiliates and for TDC, a leading telecommunications carrier in Denmark.

Our Retail business consists of retail prepaid calling cards, which are marketed through distributors primarily to ethnic communities within major metropolitan markets in the United States, and Pingo®, a prepaid calling service that we offer and sell directly to consumers via an eCommerce model. Both can be private-labeled for other service providers. The prepaid calling card business and Pingo leverage our existing international network and have the potential to deliver higher margins than are typically achieved in the wholesale Trading business. In addition, the retail prepaid calling card business typically has a faster cash collection cycle than the wholesale Trading business. In 2007, we launched PingoBusiness, enhancements that enable businesses to manage multiple Pingo accounts through a single administrative account.

We use proprietary, patented and patent-pending technology in our global VoIP network to automate the selection of routes and termination partners based on a variety of performance, quality, and business metrics. We have call termination agreements with local service providers in more than 100 countries in North America, Europe, Asia, the Middle East, Latin America, Africa and Australia.

**Transaction with KPN B.V., a subsidiary of Royal KPN N.V.**

On October 1, 2007, iBasis, Inc. ("iBasis," the "Company", "we" and "our") and KPN B.V., a subsidiary of Royal KPN, completed transactions ("KPN Transaction") pursuant to which iBasis issued 40,121,074 shares of its common stock to KPN and acquired the outstanding shares of two subsidiaries of KPN (collectively, "KPN GCS"), which encompassed KPN's international wholesale voice business. The Company also received \$55 million in cash from KPN, subject to post-closing adjustments based on the working capital and debt of iBasis and KPN GCS as described elsewhere in this Quarterly Report on Form 10-Q. Immediately after issuance on October 1, 2007, the shares of iBasis common stock issued to KPN represented 51% of the issued and outstanding shares of iBasis common stock on a fully-diluted basis (which included all of the issued and outstanding common stock and the common stock underlying outstanding "in-the-money" stock options, as adjusted, and warrants to purchase common stock). On October 8, 2007, iBasis paid a dividend in the amount of \$113 million at a rate of \$3.28 per share to each of its shareholders on the record date of September 28, 2007, the trading date immediately prior to the closing date of the KPN Transaction.

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The officers of iBasis immediately prior to the closing of the KPN Transaction have continued to serve as the officers of the combined company and one executive of KPN GCS, Edwin van Ierland, was appointed as the Company's Senior Vice President Worldwide Sales. Upon the closing of the KPN Transaction, Messrs. Charles Skibo and David Lee, two independent members of iBasis' board of directors, resigned as members of the board of directors and the board of directors of iBasis appointed Messrs. Eelco Blok and Joost Farwerck, two executives of Royal KPN N.V., as directors to fill the vacancies created by the resignations of Messrs. Skibo and Lee.

Although iBasis acquired all of the outstanding capital stock of KPN GCS, after the closing of the transaction, KPN holds a majority of the outstanding common stock of iBasis and KPN's director designees are expected to represent, at a future date, a majority of the Company's board of directors. Accordingly, for accounting and financial statement purposes, the KPN Transaction was treated as a reverse acquisition of iBasis by KPN GCS under the purchase method of accounting and the financial results of KPN GCS became the historical financial results of the combined company and replace the historical financial results of iBasis as a stand-alone company.

### **Tender Offer by Royal KPN**

On July 13, 2009, the Company's Board of Directors received a letter from Royal KPN stating its intention to commence a tender offer, through its subsidiary KPN (the "Purchaser"), to acquire all of the shares of the Company's common stock not owned by KPN at an offer price of \$1.55 per share in cash (the "Offer"). On July 15, 2009, the Board of Directors of the Company unanimously approved the creation of a special committee (the "Special Committee"), composed of W. Frank King (Chairman), Charles N. Corfield and Robert H. Brumley, to evaluate the Offer and make a recommendation to the stockholders of the Company. On July 28, 2009, the Purchaser commenced the Offer and described the terms of the Offer in a Tender Offer Statement filed with the SEC under cover of Schedule TO. On July 30, 2009, the Company, acting through the Special Committee, responded to the Offer by filing under Schedule 14D-9, which contained the unanimous recommendation of the Special Committee that the Company's stockholders reject the Offer and not tender their shares pursuant to the Offer, because the tender offer price of \$1.55 per share was grossly inadequate, opportunistic and not in the best interests of the Company's shareholders.

On July 30, 2009, the Board of Directors approved the adoption of a limited duration shareholder rights plan. The rights plan was implemented through the Company's entry into a rights agreement with Computershare Trust Company, N.A., as rights agent, and the declaration of a non-taxable dividend distribution of one preferred stock purchase right (each, a "Right") for each outstanding share of the Company's common stock. The dividend is payable on August 10, 2009 to holders of record as of the close of business on August 10, 2009. Each right is attached to and trades with the associated share of common stock. The rights will become exercisable only if a person acquires beneficial ownership of 15% or more of the Company's common stock (or, in the case of a person who beneficially owned 15% or more of the Company's common stock on the date the rights plan was adopted, such person acquires beneficial ownership of any additional shares of the Company's common stock) or after the date of the Rights Agreement, commences a tender offer that, if consummated, would result in beneficial ownership by a person of 15% or more of the Company's common stock. The rights will expire on July 30, 2010, unless the rights are earlier redeemed or exchanged. A copy of the rights agreement was filed with the SEC on July 30, 2009 as Exhibit 4.1 to the Company's Current Report on Form 8-K.

On August 3, 2009, the Company filed a lawsuit in the Court of Chancery in the State of Delaware, against Royal KPN, Purchaser, other KPN entities and certain members of KPN's management and Supervisory Board (collectively, the "Defendants") with respect to the Offer. The complaint asserts: several counts for breaches of fiduciary duty against certain of the Defendants, aiding and abetting the breaches of fiduciary duty against certain of the Defendants, civil conspiracy against all

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Defendants, and fraudulent inducement against certain of the Defendants. The complaint seeks, among other relief, to enjoin the Offer.

As a result of the commencement of the Offer by KPN and our filing of the complaint against the Defendants, we expect to incur significant expenses during the three months ended September 30, 2009, primarily for legal and investment banking consultation to the Company's Special Committee and Board of Directors.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements. The preparation of these financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires us to (i) make judgments, assumptions and estimates that affect the reported amounts of assets, liabilities, revenue and expenses; and (ii) disclose contingent assets and liabilities. A critical accounting estimate is an assumption that could have a material effect on our consolidated financial statements if another, also reasonable, amount were used or a change in the estimates is reasonably likely from period to period. We base our accounting estimates on historical experience and other factors that we consider reasonable under the circumstances. However, actual results may differ from these estimates. To the extent there are material differences between our estimates and the actual results, our future financial condition and results of operations will be affected. Our critical accounting policies and estimates are described in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2008. There have been no changes to these critical accounting policies and estimates for the three and six months ended June 30, 2009.

### **Out-of-Period Adjustments**

During the three months ended June 30, 2009, we identified immaterial errors in our consolidated financial statements for the years ended December 31, 2005 and 2008 and the three months ended March 31, 2009. These errors related to understating depreciation expense (totaling \$1.2 million in additional expense, net of tax in 2008 and \$0.6 million in additional expense, net of tax, in the three months ended March 31, 2009) and understating the valuation of foreign denominated accounts receivable (totaling \$1.7 million in an additional gain, net of tax) in 2005. As a result of these errors, net income was understated by approximately \$1.7 million in 2005 and net loss was understated by approximately \$1.2 million in 2008 and \$0.6 million in the three months ended March 31, 2009. We corrected these errors during the three months ended June 30, 2009. The combined impact to correct these errors on the three and six months ended June 30, 2009 results of operations was to increase net loss by \$0.1 million and decrease net loss by \$0.5 million, respectively. We evaluated these errors considering both qualitative and quantitative factors and considered the impact of these errors in relation to the periods in which they originated, as well as the current period, which is when they were corrected. We have concluded that these adjustments are not material to any prior periods' consolidated financial statements nor are they expected to be material to the year ending December 31, 2009. As such, these out-of-period errors were recorded in our Statement of Operations for the three months ended June 30, 2009.

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## Results from Operations

The following table sets forth for the periods indicated the principal items included in the Condensed Consolidated Statements of Operations as a percentage of total net revenue:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net revenue—external parties	80.1%	82.9%	81.5%	83.7%
Net revenue—related parties	19.9	17.1	18.5	16.3
Total net revenue	100.0	100.0	100.0	100.0
Costs and operating expenses:				
Data communications and telecommunications—external parties	79.8	82.5	80.9	82.3
Data communications and telecommunications—related parties	7.0	7.1	6.4	7.1
Engineering and network operations	2.1	1.7	2.0	1.8
Selling, general and administrative	7.0	5.4	6.9	5.7
Depreciation and amortization	4.5	2.3	3.8	2.3
Total costs and operating expenses	100.3	99.0	100.0	99.2
Income (loss) from operations	(0.3)	1.0	(0.0)	0.8
Interest income (expense), net	(0.2)	(0.0)	(0.2)	(0.1)
Foreign exchange gain (loss), net	0.1	(0.2)	(0.1)	(0.1)
Income (loss) before provision for income taxes	(0.4)	0.8	(0.3)	0.6
Provision for income taxes	1.3	0.8	0.8	0.9
Net income (loss)	(1.7)%	0.0%	(1.1)%	(0.3)%

### Three Months Ended June 30, 2009 Compared to the Three Months Ended June 30, 2008

*Net revenue.* Our primary source of revenue from external parties are the fees that we charge customers for completing voice and fax calls over our network. We charge our customers fees, per minute of traffic, that are dependent on the length and destination of the call and recognize this revenue in the period in which the call is completed. Revenue from related parties consists of fees that we charge KPN and its affiliates for the traffic they send to us to complete over our network. The fees that we charge KPN and its affiliates are based on the pricing in established service level agreements. Our average revenue per minute ("ARPM") is based upon our total net revenue divided by the number of minutes of traffic over our network for the applicable period. Our average margin per minute ("AMPM") is based upon our total revenue less total data communications and telecommunications costs divided by the number of minutes of traffic over our network for the applicable period. ARPM and AMPM are key telecommunications industry financial measurements. We believe these measurements are useful in understanding our financial performance, as well as industry trends. Although the long distance telecommunications industry has been experiencing declining prices in recent years due to the effects of deregulation and increased competition, our ARPM and AMPM can fluctuate from period to period as a result of shifts in traffic over our network to higher priced, or lower priced, destinations.

Total revenue was \$241.3 million for the three months ended June 30, 2009 compared to \$360.8 million for the same period in 2008. Revenue from external parties was \$193.2 million for the three months ended June 30, 2009 compared to \$299.2 million for the same period in 2008. The decrease in revenue from external parties primarily reflects the results of a new pricing initiative, which



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we commenced in the fourth quarter of 2008, which has focused our efforts on higher margin traffic and elimination or reduction in low margin or unprofitable traffic, as well as the effect of the global economic downturn. Our gross profit, defined as total net revenue less total data communications and telecommunications costs, as a percentage of total revenue, improved to 13.2% for the three months ended June 30, 2009 from 10.4% for the same period in 2008. The weaker euro in the three months ended June 30, 2009 also resulted in a decrease in total revenue of approximately \$24 million in U.S. dollars, on our euro-denominated revenue over the same period in 2008. In addition, the current adverse global economic conditions has contributed to a year-to-year decline in the amount of traffic we receive from prepaid calling card providers and wholesale carriers whose traffic comes from prepaid calling card providers.

Revenue from related parties for the three months ended June 30, 2009 was \$48.1 million, compared to \$61.7 million for the same period in 2008. The decrease in revenue was primarily due to the effect of the weaker euro year-to-year on this euro-denominated revenue.

Minutes of traffic for the three months ended June 30, 2009 were 4.7 billion minutes compared to 6.2 billion minutes for the same period in 2008. Average revenue per minute was 5.14 cents per minute for the three months ended June 30, 2009, compared to 5.84 cents per minute for the same period in 2008. Average margin per minute for the three months ended June 30, 2009 was 0.68 cents per minutes compared to 0.61 cents per minute for the same period in 2008.

*Data communications and telecommunications costs.* Data communications and telecommunications costs are comprised primarily of termination and circuit costs. Termination costs are paid to local service providers, or to KPN and its affiliates, to terminate voice and fax calls received from our network. Termination costs are negotiated with the local service providers and termination costs for traffic we send to KPN and its affiliates are based primarily on pricing in service level agreements. Circuit costs primarily include fees for connections between our network and our customers and/or service provider partners and charges for Internet access at our Internet Central Offices.

Total data communications and telecommunications costs were \$209.5 million for the three months ended June 30, 2009 compared to \$323.4 million for the same period in 2008. Data communications and telecommunications costs from external parties were \$192.6 million for the three months ended June 30, 2009 compared to \$297.8 million for the same period in 2008. This decrease primarily reflects the lower revenue year-to-year. Data communications and telecommunications costs from related parties were \$16.9 million for the three months ended June 30, 2009 compared to \$25.6 million for the same period in 2008. As a percentage of total net revenue, total data communications and telecommunications costs were 86.8% for the three months ended June 30, 2009 compared to 89.6% for the same period in 2008.

*Engineering and network operations expenses.* Engineering and network operations expenses include the expenses associated with developing, operating and supporting our network and expenses for operating our network operations centers. Also included in this category are engineering expenses incurred in developing, enhancing and supporting our network and our proprietary software applications. Engineering and network operations support of our TDM network are provided by KPN and charged to us under a service level agreement.

Engineering and network operations expenses were \$4.9 million for the three months ended June 30, 2009 compared to \$6.0 million for the same period in 2008. The reduction in engineering and network operations expenses reflect the reduced level of support from KPN as a result of our integration efforts and the migration of our mid-range voice product to our VoIP network.

*Selling, general and administrative expenses.* Selling, general and administrative expenses include salaries, payroll tax and benefit expenses, and other costs for sales and marketing functions and general corporate functions, including executive management, finance, legal, facilities, information technology and human resources.

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Selling, general and administrative expenses were \$16.8 million for the three months ended June 30, 2009 compared to \$19.4 million for the same period in 2008. The decrease in expenses reflects lower administrative support costs from KPN, as well as our continued monitoring and control of expenses. The decrease in support costs from KPN primarily reflects the result of our integration of our Netherlands and U.S. operations. During the three months ended June 30, 2009, we began using a new enterprise resource planning ("ERP") system, as well as a new billing system, which has allowed us to centralize our finance function, rate management and commercial operations. These new systems enable us to gain efficiencies in manpower, as well as provide improved visibility and control over our sources of revenue.

*Depreciation and amortization expenses.* Depreciation and amortization expenses were \$10.8 million for the three months ended June 30, 2009, compared to \$8.5 million for the same period in 2008. During the three months ended June 30, 2009, we corrected an error totaling \$1.8 million which related to prior periods (See Out-of-Period Adjustments noted). Excluding the effect of the correction of this error, the increase in depreciation and amortization expense primarily reflects a higher level of amortization of our intangible assets.

*Interest income and expense.* Interest expense, net was \$0.3 million for the three months ended June 30, 2009 compared to \$30,000 for the same period in 2008. The increase in interest expense, net, primarily relates to interest and related fees on borrowings under our Loan Agreement with Silicon Valley Bank.

*Foreign exchange gain (loss), net.* Foreign exchange gain, net was \$0.2 million for the three months ended June 30, 2009, compared to a loss of \$0.5 million for the same period in 2008. These foreign exchange gains and losses are primarily the result of the change in exchange rates between the U.S. dollar and the euro on our euro-denominated assets and liabilities. During the three months ended June 30, 2009, we corrected an error totaling \$2.3 million (\$1.7 million net of tax) which related to prior periods (See Out-of-Period Adjustments noted above). Excluding the effect of the correction of this error, foreign exchange loss, net was \$2.5 million for the three months ended June 30, 2009.

*Income taxes.* The income tax provision was \$3.1 million for the three months ended June 30, 2009 and \$2.9 million for the same period in 2008 and primarily relates to income taxes on the taxable income of our operations in The Netherlands. In 2009, we expect to generate taxable income in the U.S. and lower taxable income in The Netherlands, compared to 2008, primarily as a result of the integration of our U.S. and Netherlands operations. In the U.S., we will be able to utilize our available net operating loss carry forwards to offset this expected taxable income.

## **Six Months Ended June 30, 2009 Compared to the Six Months Ended June 30, 2008**

*Net revenue.* Total revenue was \$496.8 million for the six months ended June 30, 2009 compared to \$685.7 million for the same period in 2008. Revenue from external parties was \$405.0 million for the six months ended June 30, 2009 compared to \$573.8 million for the same period in 2008. The decrease in revenue from external parties primarily reflects the results of a new pricing initiative, which we commenced in the fourth quarter of 2008, which has focused our efforts on higher margin traffic and elimination or reduction in low margin or unprofitable traffic. As a result, our gross profit, defined as total net revenue less total data communications and telecommunications costs, as a percentage of total revenue, improved to 12.7% for the six months ended June 30, 2009 from 10.6% for the same period in 2008. The weaker euro in the six months ended June 30, 2009 also resulted in a decrease in total revenue of approximately \$45 million in U.S. dollars, on our euro-denominated revenue over the same period in 2008. In addition, the current adverse global economic conditions has contributed to a year-to-year decline in the amount of traffic we receive from prepaid calling card providers and wholesale carriers whose traffic comes from prepaid calling card providers.

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Revenue from related parties for the six months ended June 30, 2009 was \$91.8 million, compared to \$111.9 million for the same period in 2008. The decrease in revenue was primarily due to the effect of the weaker euro year-to-year on this euro-denominated revenue.

Minutes of traffic for the six months ended June 30, 2009 were 9.8 billion minutes compared to 12.0 billion minutes for the same period in 2008. Average revenue per minute was 5.06 cents per minute for the six months ended June 30, 2009, compared to 5.72 cents per minute for the same period in 2008. Average margin per minute for the six months ended June 30, 2009 was 0.64 cents per minutes compared to 0.61 cents per minute for the same period in 2008.

*Data communications and telecommunications costs.* Total data communications and telecommunications costs were \$434.0 million for the six months ended June 30, 2009 compared to \$612.9 million for the same period in 2008. Data communications and telecommunications costs from external parties were \$401.8 million for the six months ended June 30, 2009 compared to \$564.2 million for the same period in 2008. This decrease primarily reflects the lower minutes of traffic year-to-year. Data communications and telecommunications costs from related parties were \$32.2 million for the six months ended June 30, 2009 compared to \$48.7 million for the same period in 2008. As a percentage of total net revenue, total data communications and telecommunications costs were 87.3% for the six months ended June 30, 2009 compared to 89.4% for the same period in 2008.

*Engineering and network operations expenses.* Engineering and network operations expenses were \$10.0 million for the six months ended June 30, 2009 compared to \$12.7 million for the same period in 2008. The reduction in engineering and network operations expenses reflect the reduced level of support from KPN as a result of our integration efforts and the migration of our mid-range voice product to our VoIP network.

*Selling, general and administrative expenses.* Selling, general and administrative expenses were \$34.0 million for the six months ended June 30, 2009 compared to \$39.3 million for the same period in 2008. The decrease in expenses reflects lower administrative support costs from KPN, as well as our continued monitoring and control of expenses. The decrease in support costs from KPN primarily reflects the result of our integration of our Netherlands and U.S. operations. During the six months ended June 30, 2009, we began using a new enterprise resource planning ("ERP") system, as well as a new billing system, which has allowed us to centralize our finance function, rate management and commercial operations. These new systems enable us to gain efficiencies in manpower, as well as provide improved visibility and control over our sources of revenue.

*Depreciation and amortization expenses.* Depreciation and amortization expenses were \$19.0 million for the six months ended June 30, 2009, compared to \$15.7 million for the same period in 2008. During the six months ended June 30, 2009, we corrected an error totaling \$1.8 million which related to prior periods (See Out-of-Period Adjustments noted above). Excluding the effect of the correction of this error, the increase in depreciation and amortization expense primarily reflects a higher level of amortization of our intangible assets.

*Interest income and expense.* Interest expense, net was \$0.9 million for the six months ended June 30, 2009 compared to \$0.5 million for the same period in 2008. The increase in interest expense, net, primarily relates to interest and related fees on borrowings under our Loan Agreement with Silicon Valley Bank.

*Foreign exchange gain (loss), net.* Foreign exchange loss, net was \$0.4 million for the six months ended June 30, 2009, compared to a loss of \$0.8 million for the same period in 2008. During the six months ended June 30, 2009, we corrected an error totaling \$2.3 million (\$1.7 million net of tax) which related to prior periods (See Out-of-Period Adjustments noted above). These foreign exchange gains and losses are primarily the result of the change in exchange rates between the U.S. dollar and the

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euro on our euro-denominated assets and liabilities. Excluding the effect of the correction of this error, foreign exchange loss, net was \$2.7 million for the six months ended June 30, 2009.

*Income taxes.* The income tax provision was \$4.1 million for the six months ended June 30, 2009 and \$6.0 million for the same period in 2008 and primarily relates to income taxes on the taxable income of our operations in The Netherlands. In 2009, we expect to generate taxable income in the U.S. and lower taxable income in The Netherlands, compared to 2008, primarily as a result of the integration of our U.S. and Netherlands operations. In the U.S., we will be able to utilize our available net operating loss carry forwards to offset this expected taxable income.

## **Liquidity and Capital Resources**

Cash provided by operating activities was \$20.2 million in the six months ended June 30, 2009 and was the result of the net loss of \$5.7 million, after non-cash charges of \$21.1 million and by net changes in operating assets and liabilities of \$4.8 million. Non-cash charges for the six months ended June 30, 2009 consisted primarily of depreciation and amortization expense. The net change of \$4.8 million in operating assets and liabilities was primarily a result of reduction in accounts receivable—external parties of \$24.0 million, partially offset by a reduction in accounts payable—external parties of \$9.6 million and accrued expenses of \$9.0 million. The reduction in accounts receivable—external parties, accounts payable—external parties and accrued expenses is largely a result of the lower level of revenue during the six months ended June 30, 2009. In addition, the reduction in accounts receivable—external parties reflects improved accounts receivable collections.

Cash provided by operating activities was \$15.5 million in the six months ended June 30, 2008 and was the result of the net loss of \$(2.1) million and changes in other assets and liabilities of \$(4.1) million, offset by non-cash charges of \$17.9 million, primarily depreciation and amortization. Accounts receivable and unbilled revenue, net—external parties increased by \$23.2 million and accounts payable—external parties and accrued expenses, combined, increased by \$33.7 million. These increases primarily reflected the higher sequential quarterly revenue and related data and telecommunications costs.

Cash used in investing activities in the six months ended June 30, 2009 consisted of \$2.8 million used for purchases of property and equipment.

Cash flows used in investing activities in the six months ended June 30, 2008 was \$11.0 million. Additions to property and equipment were \$7.0 million in the six months ended June 30, 2008. On April 1, 2008, we acquired certain assets from TDC, the leading telecommunications carrier in Denmark, as well as certain assets, contracts and employees of TDC's subsidiary in the U.S., TDC Carrier Services U.S., for approximately \$10.9 million in cash and incurred \$0.1 million in legal fees. Cash provided by investing activities included a reduction in other assets, relating to investing activities, of \$5.0 million and maturities of short-term marketable securities of \$2.0 million.

Cash used in financing activities in the six months ended June 30, 2009 consisted of repayments of \$8.1 million of our bank borrowings and a principal payments of \$10.0 million to fully pay-off our Working Capital Loan to KPN. The repayments of \$8.1 million of our bank borrowings were a result of lower borrowing capability under our Loan Agreement with Silicon Valley Bank. The reduction in borrowing capability was primarily a result of a decline in accounts receivable due to the revenue in the six months ended June 30, 2009. Payments of capital lease obligations were \$0.3 million.

Cash used in financing activities in the six months ended June 30, 2008 was \$5.7 million. We borrowed an additional \$5.0 million under our bank line of credit during the period. We made our first installment payment on our working capital adjustment indebtedness with KPN of \$4.7 million and made purchases of our common stock in the amount of \$4.9 million under our stock repurchase program during that period. Payments of capital lease obligations were \$1.1 million.

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On January 26, 2009, the Company and Silicon Valley Bank modified the Loan Agreement, effective as of December 30, 2008 to reduce the amount available under the Loan Agreement from \$50.0 million to \$35.0 million, extend the maturity date of the Loan Agreement to September 30, 2010 and to modify certain financial covenants. In connection with this modification, we paid Silicon Valley Bank a modification fee of \$52,500 and a revolving line renewal fee of \$175,000. See Note 11 "Line of Credit and Long-Term Debt" of our Condensed Notes to Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q for further information on our Loan Agreement.

At June 30, 2009 and December 31, 2008, we had \$19.0 million and \$27.1 million, respectively, in borrowings outstanding, and had issued outstanding standby letters of credit of \$2.5 million and \$2.6 million, respectively, under the Loan Agreement. As of June 30, 2009, we were in compliance of all of the covenants under the Loan Agreement.

In the six months ended June 30, 2009, we purchased certain equipment for \$0.4 million under a four year financing agreement, with payments due monthly through May 2013. In the six months ended June 30, 2008, we purchased certain software licenses for \$1.7 million under a 30-month financing agreement, with payments due on a semi-annual basis through June 2010.

We anticipate that our June 30, 2009 balance of \$57.3 million in cash and cash equivalents, together with expected net cash flow generated from operations, will be sufficient to fund our operations and capital asset expenditures for the next twelve months. We expect capital asset expenditures to be between \$10 million to \$14 million in 2009.

### **Off-Balance Sheet Arrangements**

Under accounting principles generally accepted in the U.S., certain obligations and commitments are not required to be included in the consolidated balance sheets and statements of operations. These obligations and commitments, while entered into in the normal course of business, may have a material impact on liquidity. As of June 30, 2009, we do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

### **Contractual Obligations**

The following table summarizes our future contractual obligations as of June 30, 2009:

	<u>Total</u>	<u>Payment Due Dates</u>				
		<u>Less than 1 Year</u>	<u>1 to 2 Years</u>	<u>2 to 3 Years</u>	<u>3 to 5 Years</u>	<u>After 5 Years</u>
			(In thousands)			
Bank borrowings	\$18,951	\$ —	\$18,951	\$ —	\$ —	\$ —
Interest on bank borrowings(1)	1,362	1,090	272	—	—	—
Capital lease obligations, including interest	993	718	103	103	69	—
Operating leases	7,058	2,496	1,137	855	1,209	1,361
Purchase commitments for termination of minutes	35,630	35,630	—	—	—	—
<b>Total</b>	<b>\$63,994</b>	<b>\$ 39,934</b>	<b>\$20,463</b>	<b>\$958</b>	<b>\$1,278</b>	<b>\$1,361</b>

- (1) Interest payments on bank borrowings are projected using our borrowing rate as of June 30, 2009. Future interest payments may differ from these amounts based on changes in market interest rates.

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As of June 30, 2009, the total amount of net unrecognized tax benefits for uncertain tax positions and the accrual for the related interest was \$0.7 million. We are unable to make a reasonably reliable estimate of when cash settlement, if any, will occur with a tax authority as the timing of examinations and ultimate resolution of those examinations is uncertain.

### **New Accounting Pronouncements**

For a description of new accounting pronouncements, see Note 1 "Business and Presentation" of our Condensed Notes to Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q.

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

Our primary market risk exposure is related to interest rates and foreign currency exchange rates. We are exposed to foreign currency risk which can create volatility in earnings and cash flows from period to period. Historically, KPN GCS sought to economically hedge a portion of its foreign currency risk arising from foreign exchange receivables and foreign currency-denominated forecasted transactions. Foreign exchange contracts were used to fix or protect the exchange rate to be used for foreign currency-denominated transactions. Hedge accounting was not applied in the historical financial statements of KPN GCS. We do not currently engage in trading market risk sensitive instruments or purchasing hedging instruments, whether interest rate, foreign currency exchange, commodity price or equity price risk and have not purchased options or entered into swaps or forward or futures contracts.

Our revenues are primarily denominated in U.S. dollars or euros. Thus, we are exposed to foreign currency exchange rate fluctuations as the financial results and balances of our foreign entities are converted into U.S. dollars. As exchange rates vary, these results, when converted, may vary from expectations and may adversely impact our results of operations and financial condition. For example, if the dollar weakens relative to the euro, our euro denominated revenues and expenses would increase when stated in U.S. dollars. Conversely, if the U.S. dollar strengthens relative to the euro, our euro denominated revenues and expenses would decrease.

Our primary interest rate risk is the risk on borrowings under our Loan Agreement with Silicon Valley Bank, which is subject to interest rates based on the bank's prime rate or LIBOR, plus margin. We had \$19.0 million in borrowings under our Loan Agreement at June 30, 2009. If, for example, interest rates were to increase by 1%, this would result in additional annual interest expense of \$0.2 million on our current level of borrowings. A change in the applicable interest rates would also affect the rate at which we could borrow funds or finance equipment purchases. Our capital lease obligations are fixed rate debt.

### **Item 4. *Controls and Procedures***

#### *Disclosure Controls and Procedures*

Our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that, based on such evaluation, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.



[Table of Contents](#)*Changes in Internal Control Over Financial Reporting*

During the three months ended June 30, 2009, we began using a new Enterprise Resource Planning ("ERP") system, as well as a new central customer billing system. Implementing this new ERP and billing system involved significant changes in business processes that management believes will provide meaningful benefits, including more standardized and efficient processes throughout the Company. For the quarter ended June 30, 2009, there were material changes to our internal controls over financial reporting related to the implementation of the ERP system. The changes in business processes primarily affected our customer billing process and recording and reporting of revenues and expenditures. While we believe that this new system and the related changes to internal controls will strengthen our internal controls over financial reporting, there are inherent risks in implementing any new ERP system and we will continue to evaluate and test these control changes in order to provide certification as of year-end on the effectiveness, in all material respects, of our internal controls over financial reporting.

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**Part II—Other Information**

**Item 1. Legal Proceedings**

The discussion of legal proceedings in Note 12 "Commitments and Contingencies" of our Condensed Notes to Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q is hereby incorporated by reference.

In addition, for a description of the complaint we filed against Royal KPN and its affiliates in August 2009 relating to the unsolicited tender offer by KPN, please see the legal proceedings described under the heading "Tender Offer by Royal KPN" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," contained in this Quarterly Report on Form 10-Q.

**Item 1A. Risk Factors**

In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed in Part I, "Item 1A: Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**KPN's tender offer to purchase all of our outstanding common stock is disruptive to our business and threatens to adversely affect the Company's financial condition and results of operations.**

On July 13, 2009, our Board of Directors received a letter from Royal KPN indicating its intention to commence a tender offer, through its subsidiary KPN, to acquire all of the shares of our common stock not owned by KPN at an offer price of \$1.55 per share in cash (the "Offer"). On July 15, 2009, our Board of Directors of the Company unanimously approved the creation of a special committee (the "Special Committee"), composed of W. Frank King (Chairman), Charles N. Corfield and Robert H. Brumley, to evaluate the Offer and make a recommendation to our stockholders. On July 28, 2009, the Purchaser commenced the Offer and described the terms of the Offer in a Tender Offer Statement filed with the SEC under cover of Schedule TO. On July 30, 2009, the Company, acting through the Special Committee, responded to the Offer by filing under Schedule 14D-9, which contained the unanimous recommendation of the Special Committee that our stockholders reject the Offer and not tender their shares pursuant to the Offer, because the tender offer price of \$1.55 per share was grossly inadequate, opportunistic and not in the best interests of the Company's shareholders.

The Offer is highly conditional and creates substantial uncertainties. The Offer may adversely impact our ability to attract new customers and may cause potential or current customers to seek alternative suppliers. In particular, the Offer may adversely impact our ability to successfully market and sell our products and services. Additionally, the Offer may create uncertainty for our management, employees, current and potential customers, suppliers and other third parties. This uncertainty could adversely affect our ability to retain key employees and to hire new talent, cause third parties to terminate their relationship with us, or not to renew or enter into arrangements with us; and negatively impact our business during the pendency of the Offer.

In addition, the review and response to the Offer requires the expenditure of significant time and resources by us and may be a significant distraction for our management and employees. Additionally, we, including, members of our Board of Directors may be named in lawsuits related to the Offer. Any future lawsuits may become burdensome and result in significant costs of defense, indemnification, and liability. Each of these factors, individually or in the aggregate, may adversely affect our financial condition and results of operations.



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### **KPN, our controlling stockholder, may seek to influence our business in a manner that is adverse to us or adverse to other stockholders who may be unable to prevent actions by KPN.**

As our majority stockholder, KPN controls the outcome of most actions requiring the approval of our stockholders. Our Second Amended and Restated By-laws, as amended, provide among other things, that during the control period (as defined therein), no fewer than two members of the Company's Board of Directors will be nominated by KPN. In addition, commencing on October 1, 2009, in connection with any annual or special meeting of stockholders at which members of the Board of Directors are to be elected that is held during the control period, no fewer than two additional directors will be nominated by KPN, provided, that if the aggregate number of directors serving on the Board of Directors is increased during the control period, the number of directors nominated by KPN will be increased proportionately. The By-laws also provide that, following October 1, 2009, the Company's chief executive officer may be removed and replaced by a unanimous vote of the KPN-nominated directors and any independent directors. Further, during the control period, a resolution of the Board of Directors with respect to the following matters may not be approved, absent exceptional circumstances, without the approval of a majority of the entire Board of Directors, including the unanimous approval of the KPN-nominated directors:

- the appointment or removal of the Company's chief financial officer;
- the approval of the Company's annual budget or three-year business plan;
- any financings, guarantees, acquisitions, dispositions, incurrences of liens or other encumbrances (or any series of related financings, guarantees, acquisitions, dispositions, incurrences of liens or other encumbrances), that involve, in each case the aggregate payment or receipt by (or incurrence of obligations of or to) the Company or any of the Company's subsidiaries or other affiliates of consideration in excess of \$10,000,000;
- any one or series of related mergers, consolidations or other similar transactions that involve the aggregate payment or receipt by (or incurrence of obligations of or to) the Company or any of the Company's subsidiaries or other affiliates of consideration in excess of \$10,000,000;
- any investments, reorganizations, joint ventures, partnerships, leases or capital expenditures (or any series of related investments, reorganizations, joint ventures, partnerships, leases or capital expenditures), that involve, in each case, the aggregate payment or receipt by (or incurrence of obligations of or to) the Company or any of the Company's subsidiaries or other affiliates of consideration in excess of \$10,000,000 which are not covered in the Company's annual budget;
- any issuance, grant, sale or offer or any repurchase, reduction, redemption, conversion, sub-division, consolidation, cancellation or otherwise by the Company of Shares, other capital stock or any instruments with voting rights or that are convertible into capital stock, including options and warrants, other than upon the exercise of options, warrants or other convertible securities outstanding on October 1, 2007, pursuant to the terms of such options, warrants and other convertible securities;
- any declaration by the Company of dividends or other distributions to stockholders;
- any amendments to the Company's certificate of incorporation or by-laws; and
- any commencement of voluntary bankruptcy proceedings, dissolution or similar proceedings by the Company or any of the Company's subsidiaries or other affiliates.

Currently, two of our directors—Messer. Eelco Blok and Joost Farwerck—also serve as officers of KPN or affiliates of KPN. We cannot assure that KPN will not seek to influence our business in a manner that is contrary to our goals or strategies, or the interests of other stockholders. Moreover,

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persons who are directors of iBasis and who are also officers of KPN may decline to take actions in a manner that might be favorable to us but adverse to KPN.

### **The Company's stock price has been volatile and may continue to fluctuate significantly.**

As a result of KPN's unsolicited tender offer, as well as the recent volatility in general market conditions, the market price of the Company's common stock has been subject to significant fluctuations. The future trading price of the Company's common stock is likely to be volatile and could be subject to wide price fluctuations.

### ***SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS***

This Quarterly Report on Form 10-Q and, in particular, our Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Part I—Item 2 contain or incorporate a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act including statements regarding:

- our expectations regarding the outcome of the legal proceedings that we are currently a party to, including our defense strategies, the results of negotiations and settlements in such legal proceedings and our estimates regarding the amount of fees and losses to be paid in connection with such legal proceedings;
- our expectations that the VoIP market offers significant growth potential for us;
- the potential of our prepaid calling card business and Pingo to generate higher margins;
- uncertainty related to the unsolicited tender offer commenced by KPN and litigation that we have initiated relating to the tender offer;
- our expectations regarding our ability to generate taxable income in the U.S. and lower taxable income in The Netherlands;
- uncertainty related to current economic conditions and the related impact on demand for our products; and
- our liquidity.

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Quarterly Report on Form 10-Q will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially.

Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects" and similar expressions are intended to identify forward-looking statements. There are a number of factors that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control, including the factors set forth under "Item 1A. Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2008, as updated or supplemented by "Part II—Item 1A—Risk Factors" of this Quarterly Report on Form 10-Q. In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

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**Item 4A. Submission of Matters to a Vote of Security Holders**

On May 26, 2009, the Company held its Annual Meeting of Shareholders. At the meeting, shareholders voted upon three matters. On the first matter, the shareholders re-elected Messrs. Ofer Gneezy and Charles N. Corfield as Class 1 directors to serve on the Company's board of directors until the annual meeting of shareholders to be held in 2012 and until their successors are duly elected and qualified or until their earlier resignation or removal. In addition, although Class 2 and 3 directors were not the subject of shareholder votes at the annual meeting, Gordon J. VanderBrug, Eelco Blok and W. Frank King currently serve as the Company's Class 2 directors with terms ending at the 2010 annual meeting of shareholders and Robert H. Brumley and Joost Farwerck currently serve as the Company's Class 3 directors with terms ending at the 2011 annual meeting of shareholders.

On the second matter, the shareholders ratified the adoption of the iBasis, Inc. Executive Bonus Plan

On the third matter, the shareholders ratified the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2009.

The results of the shareholder votes are as follows:

	<u>For</u>	<u>Withheld</u>
<b>Election of Class 1 Directors:</b>		
Ofer Gneezy	60,640,778	2,958,822
Charles N. Corfield	62,550,811	1,048,789

	<u>For</u>	<u>Against</u>	<u>Abstentions</u>	<u>Broker non-votes</u>
<b>Ratification of adoption of iBasis, Inc. Executive Bonus Plan</b>	51,672,364	2,289,409	53,653	9,584,174

	<u>For</u>	<u>Against</u>	<u>Abstentions</u>	<u>Broker non-votes</u>
<b>Ratification of Independent Registered Public Accounting Firm:</b>				
PricewaterhouseCoopers LLP	63,518,176	75,249	6,175	0

**Item 5. Other Information.**

**Important Legal Information**

In connection with the tender offer commenced by KPN B.V., the Company has filed with the SEC a Solicitation/Recommendation Statement on Schedule 14D-9 on July 30, 2009 and amendments thereto.

**Item 6. Exhibits**

**(a) Exhibits:**

- 10.1† Form of Severance and Change-in-Control Agreement dated as of May 11, 2009, between iBasis, Inc. and each of the Chief Executive Officer and Executive Vice President (separate agreements entered into by each of Ofer Gneezy and Gordon J. VanderBrug) (incorporated by reference to Exhibit (e)(21) to the Company's Schedule 14D-9 filed with the SEC on July 30, 2009).



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- 10.2<sup>†</sup> Form of Severance and Change-in-Control Agreement dated as of May 11, 2009, between iBasis, Inc. and each Senior Vice President (separate agreements entered into by each of Richard G. Tennant, Mark S. Flynn, Paul H. Floyd and Edwin van Ierland) (incorporated by reference to Exhibit (e)(22) to the Company's Schedule 14D-9 filed with the SEC on July 30, 2009).
- 31.1<sup>\*</sup> Certification of iBasis, Inc. Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2<sup>\*</sup> Certification of iBasis, Inc. Chief Financial Officer pursuant to Section 302 of the Sarbanes- Oxley Act of 2002.
- 32.1<sup>‡</sup> Certifications of iBasis, Inc. Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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<sup>†</sup> Indicates management compensatory plan, contract or arrangement.

<sup>\*</sup> Filed herewith.

<sup>‡</sup> Furnished herewith.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**iBasis, Inc.**

August 7, 2009

By: /s/ RICHARD TENNANT

Richard Tennant  
*Senior Vice President and  
Chief Financial Officer  
(Authorized Officer and  
Principal Financial and Accounting Officer)*

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

**FORM 10-K**

(Mark  
One)

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

For the fiscal year ended December 31, 2008

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-27127

**iBasis, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**04-3332534**  
(I.R.S. Employer  
Identification No.)

**20 Second Avenue, Burlington, MA 01803**  
(Address of principal executive offices, including zip code)

**(781) 505-7500**  
(Registrant's telephone number, including area code)

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

Title of Class	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	The NASDAQ Stock Market LLC (NASDAQ Global Market)

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

None

(Title of Class)



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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒ Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐  
(Do not check if a smaller reporting company)

Smaller reporting company ☐

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

The aggregate market value of the registrant's common stock, \$0.001 par value per share, held by non-affiliates of the registrant as of June 30, 2008 was approximately \$102,242,000 based on 31,171,405 shares held by such non-affiliates at the closing price of a share of common stock of \$3.28 as reported on The NASDAQ Global Market on such date. Affiliates of the Company (defined as officers, directors and owners of 10% or more of the outstanding share of common stock) owned 42,470,503 shares of common stock outstanding on such date.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Common Stock, par value \$0.001 per share, as of February 28, 2009

71,228,328

## DOCUMENTS INCORPORATED BY REFERENCE

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K: Certain information required in Part III of this Annual Report on Form 10-K is incorporated from the Registrant's Proxy Statement for the 2009 Annual Meeting of Stockholders.

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For the Year Ended December 31, 2008****Table of Contents**

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## PART I

### Item 1. Business

iBasis is a leading wholesale carrier of international long distance telephone calls and a provider of retail prepaid calling services and enhanced services for mobile operators.

#### Company Overview

Our operations consist of our wholesale trading business ("Trading"), in which we connect buyers and sellers of international telecommunications services, and our retail services business ("Retail"). Our Trading business also includes Outsourcing revenue which we generate as the exclusive provider of wholesale international voice services for specific carrier customers. In the Trading business we receive voice traffic from buyers—originating telecommunications carriers who are interconnected to our network via Voice over Internet Protocol ("VoIP") or traditional time division multiplexing ("TDM") connections, and we route that traffic over our network to sellers—local service providers and telecommunications carriers in the destination countries with whom we have established agreements to manage the completion or termination of calls.

As a result of the combination with KPN Global Carrier Services B.V. (KPN GCS) in October 2007 (described below), more than half of our traffic utilizes our VoIP network, while the balance is carried over our TDM network. The continued migration of the TDM traffic to our lower cost VoIP network is expected to be a significant source of synergies from the KPN transaction over the next several years.

We use proprietary, patented and patent-pending technology to automate the selection of routes and termination partners based on a variety of performance, quality, and business metrics. We offer this Trading service on a wholesale basis to carriers, mobile operators, consumer VoIP companies, telephony resellers and other service providers worldwide. We have call termination agreements with local service providers in more than 100 countries in North America, Europe, Asia, the Middle East, Latin America, Africa and Australia.

We continue to expand our market share in our Trading business by expanding our customer base, developing termination capacity, and by offering a comprehensive portfolio of cost-effective international voice solutions, including complete outsourcing of international voice traffic.

Our Trading products comprise a comprehensive voice product portfolio. We have retained the leading product from both iBasis and KPN GCS—Direct Voice and Premium Voice respectively, and we completed the portfolio with two new mid-range products—Value Voice and Certified Voice. The four products offer a progression of code coverage, pricing and features formulated to meet the varied requirements of fixed carriers, mobile operators, consumer voice over broadband carriers, and prepaid calling card service providers. Our product portfolio enables us to compete effectively in all international voice markets and gives us particular strengths in the fastest-growing segments of VoIP and mobile.

In targeting the emerging consumer VoIP providers, we offer our DirectVoIP™ and DirectSIP™ IP interconnection services, which address a range of requirements that are specific to the growing consumer VoIP market, including support for Session Initiation Protocol interconnection, which is becoming the standard for voice over broadband services. DirectSIP also includes our media normalization, or transcoding, solution, which enables us to provide greater interoperability among devices and voice applications, as well as deliver high quality service even over sub-optimal network connections.

In the mobile market, in addition to meeting mobile operators' requirements for premium quality voice service and advanced voice features, iBasis offers a portfolio of value-added mobile data services,

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called Mobile Matrix, which includes global signaling, mobile messaging and roaming to enhance mobile operators' average revenue per user and customer loyalty.

Outsourcing offers carriers a strategic solution to the commoditization of international voice. By outsourcing their international voice operations to iBasis, carriers take advantage of our efficiencies of scale, our specialization, and our highly efficient global infrastructure, which supports both VoIP and TDM traffic. Moreover, they leverage our termination agreements with hundreds of providers in more than 100 countries. Our Outsourcing customers are better able to focus their resources on higher margin, differentiating consumer services.

Our Retail business consists of retail prepaid calling cards, which are marketed through distributors primarily to ethnic communities within major metropolitan markets in the United States, and Pingo®, a prepaid calling service that we offer and sell directly to consumers via an eCommerce model. Both can be private-labeled for other service providers. The prepaid calling card business and Pingo leverage our existing international network and have the potential to deliver higher margins than are typically achieved in the Trading business. In addition, the retail prepaid calling card business typically has a faster cash collection cycle than the Trading business. In 2007, we launched PingoBusiness, enhancements that enable businesses to manage multiple Pingo accounts through a single administrative account. To date, revenues from our Pingo services have not been material.

We were incorporated as a Delaware corporation in 1996. Our principal executive offices are located at 20 Second Avenue, Burlington, Massachusetts 01803 and our telephone number is (781) 505-7500. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports, are available free of charge through the Securities and Exchange Commission's ("SEC") website at [www.sec.gov](http://www.sec.gov) or on our investor relations section of our website at <http://investor.ibasis.com> as soon as reasonably practicable after such materials have been electronically filed with, or furnished to, the SEC.

### ***KPN Transaction***

On October 1, 2007, iBasis, Inc. and KPN B.V. ("KPN"), a subsidiary of Royal KPN N.V. ("Royal KPN"), completed transactions ("KPN Transaction") pursuant to which iBasis issued 40,121,074 shares of its common stock to KPN and acquired the outstanding shares of two subsidiaries of KPN ("KPN GCS"), which encompassed KPN's international wholesale voice business. The Company also received \$55 million in cash from KPN, subject to post-closing adjustments based on the working capital and debt of iBasis and KPN GCS. Immediately after issuance on October 1, 2007, the shares of iBasis common stock issued to KPN represented 51% of the issued and outstanding shares of iBasis common stock on a fully-diluted basis (which includes all of the issued and outstanding common stock and the common stock underlying outstanding "in-the-money" stock options, as adjusted, and warrants to purchase common stock). As of December 31, 2008, the 40,121,074 shares owned by KPN represent 56% of the issued and outstanding common stock of iBasis and 56% on a fully-diluted basis, as defined above.

On October 8, 2007, iBasis paid a dividend in the amount of \$113 million at a rate of \$3.28 per share to each of its shareholders on the record date of September 28, 2007, the trading date immediately prior to the closing date of the KPN Transaction. In addition, holders of outstanding warrants to purchase our common stock will be entitled to receive a cash payment upon the future exercise of these warrants in an amount equal to the dividend amount that would have been payable if the warrants had been exercised immediately prior to the dividend record date. Cumulatively through December 31, 2008, we have paid holders of warrants a total \$0.8 million in dividends upon the exercise of their warrants. As of December 31, 2008, we have unexercised warrants representing 432,000 shares, at exercise prices ranging from \$6.30 to \$9.00 per share, and have \$1.4 million accrued for dividends to be paid upon the potential future exercise of these warrants. In connection with the

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payment of the dividend to shareholders, we also increased the number of shares subject to unexercised stock options and decreased the exercise price of these stock option grants to preserve their value.

The officers of iBasis immediately prior to the closing of the KPN Transaction have continued to serve as the officers of the combined company and one executive of KPN GCS, Mr. Edwin Van Ierland, was appointed as the Company's Senior Vice President Worldwide Sales. Upon closing of the KPN Transaction, Messrs. Charles Skibo and David Lee, two independent members of iBasis' board of directors, resigned as members of the board of directors and the board of directors of iBasis appointed Messrs. Eelco Blok and Joost Farwerck, two executives of Royal KPN, as directors to fill the vacancies created by the resignations of Messrs. Skibo and Lee.

Although iBasis acquired all of the outstanding capital stock of KPN GCS, after the closing of the transaction, KPN holds a majority of the outstanding common stock of iBasis and KPN's designees are expected to represent, at a future date, a majority of the Company's board of directors. Accordingly, for accounting and financial statement purposes, the KPN Transaction has been treated as a reverse acquisition of iBasis by KPN GCS under the purchase method of accounting and the financial results of KPN GCS have become the historical financial results of the combined company and replace the historical financial results of iBasis as a stand-alone company. Thus, the financial results reported for the full year 2007 include the results of KPN GCS stand-alone for the first nine months of 2007 and the financial results of the combined company for the fourth quarter of 2007 only.

The presentation of the Statement of Stockholders' Equity reflects the historical stockholders' equity of KPN GCS through September 30, 2007. The effect of the issuance of shares of iBasis common stock to KPN and the inclusion of iBasis' stockholders' equity as a result of the closing of the KPN Transaction on October 1, 2007 is reflected in the year ended December 31, 2007.

Prior to October 1, 2007, KPN GCS operated as an integrated part of KPN since inception and the historical financial statements of KPN GCS have been derived from the accounting records of KPN using the historical bases of assets and liabilities. Because KPN GCS did not operate as a stand-alone business the historical financial statements may not necessarily be representative of amounts that would have been reflected in the financial statements presented had KPN GCS operated independently of KPN.

KPN GCS benefited from certain related party revenue and purchase agreements with KPN that included sales prices per minute and costs per minute. KPN GCS also relied on KPN for a substantial part of its operational and administrative support, for which it was allocated costs primarily consisting of selling, general and administrative expenses, such as costs for centralized research, legal, human resources, payroll, accounting, employee benefits, real estate, insurance, information technology, telecommunications, treasury and other corporate and infrastructure costs. In anticipation of the closing of the transaction with iBasis, KPN GCS entered into a Framework Services Agreement with KPN in 2006, which replaced the related party revenue and purchase agreements and operational and administrative support arrangements described above.

In 2008, we changed the name of our Netherlands operations from KPN GCS to iBasis Netherlands.

### ***TDC Transaction***

On April 1, 2008, we acquired certain assets from TDC, the leading telecommunications carrier in Denmark, as well as certain assets, contracts and four employees of TDC's subsidiary in the U.S., TDC Carrier Services U.S., for approximately \$11 million in cash ("TDC Transaction"). Pursuant to the TDC Transaction, we became the exclusive provider of international voice services for TDC under a five-year strategic outsourcing arrangement, and TDC will be a preferred partner for terminating traffic sent by us into the Nordic region, consisting of Denmark, Finland, Iceland, Norway and Sweden.

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Approximately 130 non-Nordic international wholesale voice customers, as well as all of TDC' interconnection and bilateral agreements for inbound and outbound international phone calls have been transferred to us. TDC will retain its Nordic customer base and its pan-Nordic reach.

### **Industry Overview**

*Market Overview.* Based on the most current information available, the international voice market was estimated by TeleGeography, a market research firm, to be approximately \$78 billion in 2007, and international voice minutes grew approximately 14% over 2006. International wholesale voice traffic represented approximately \$11 billion in 2007, and minutes of traffic grew 17% over 2006 as more traffic is originated by carriers such as mobile operators, that lack international networks. We believe that wholesale traffic will continue to grow faster than the overall international voice market due to important trends. These trends involve the migration of voice traffic:

- from traditional vertically-integrated international carriers to more specialized local service providers;
- from traditional fixed line offerings to mobile; and
- from the TDM network to VoIP.

Moreover, direct connections between incumbents from different countries are only cost-effective for very large traffic flows. Wholesale carriers offer call termination to many destinations through a single connection and enable carriers to retain revenue while reducing cost of operations.

Global deregulation combined with rapid technological advances has enabled the emergence of many new communications service providers in dozens of local markets. In their efforts to remain competitive, national carriers are focusing their capital spending on "last-mile" retail services and technology initiatives such as fixed-to-mobile convergence, wireless, and cable, which deliver or promise to deliver margins that are several times greater than that of international voice service. Consequently, communications service providers are looking for ways to expand their ability to serve all of their customers' telecommunication needs, while simultaneously reducing the cost of providing international services. As the international voice business becomes increasingly commoditized, the critical success factor is the efficiency of scale. For the vast majority of carriers, international traffic represents a very small portion of their overall business. Therefore, many of the world's carriers are seeking to leverage efficient wholesale networks, such as The iBasis Network™, with lower infrastructure and transport costs that can help improve a carrier's competitiveness and bottom line, without compromising service quality. Some carrier customers turn to us for their biggest routes, some for their smallest routes, and others for all routes, effectively outsourcing their international voice traffic to iBasis.

*The Mainstreaming of VoIP.* Although the consumer adoption of VoIP services is a recent development, we have been transmitting VoIP calls for many of the world's largest carriers for several years. Managing quality of service at the core of the network, which we pioneered and mastered, has allowed phone-to-phone calls to be transmitted over the Internet with quality nearly indistinguishable from that of traditional voice networks. Enabled by the quality of VoIP service from providers like us, international VoIP traffic has grown rapidly and continues to grow much faster than international TDM traffic. According to industry analyst, TeleGeography, international VoIP traffic grew 36% to 32 billion minutes in 2004, 42% to 45 billion minutes in 2005, 31% to 61 billion minutes in 2006, 28% to 78 billion minutes in 2007, and is expected to have reached nearly 95 billion minutes in 2008, which is approximately 25% of projected international traffic worldwide.

Unlike fixed-line telecommunication networks and managed internet protocol ("IP") networks, the Internet has many potential points of congestion where information, in the form of data packets, can be delayed or dropped. For non-real-time communications, such as email, a slight delay in the receipt of a message is not significant. However, for real-time communications, such as telephone calls, the

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result of a delay in transmitting the call, or losing the call altogether, is significant. To minimize the risk of delays or losing calls over the Internet, we utilize complex and proprietary performance monitoring and call routing technology to ensure consistently high call completion and voice quality. We have developed patented and patent-pending quality management technologies that enable us to deliver call completion rates and average call durations (the standard metrics that carriers use for measuring quality) that we believe are comparable to or better than those achieved by traditional fixed-line carriers.

VoIP's principal benefits are:

- *Cost Advantage from Internet Transport.* Traditional voice networks use circuit-switching technology, which establishes dedicated channels between an originating and terminating point for the duration of a call. Physical facilities (typically fiber and associated equipment) are dedicated to voice traffic between switching nodes, regardless of changes in demand. In contrast, VoIP is based on packet-switching technology. This technology completes a call by digitizing and dividing a speaker's voice into small packets that travel to their destination along lines carrying packets of other Internet traffic, in much the same way as email travels. Using a network of service facilities connected to the public Internet for transport is less costly than building a dedicated network as our calls share the Internet with other traffic.
- *Cost Advantage from IP Technology.* VoIP gateway equipment which is used to convert and route phone calls over the Internet is less expensive and requires less physical space in telecommunication facilities than traditional telecommunications equipment.
- *Cost Advantage from Bypass of International Settlement Rates.* Traditional international long distance calls are completed through international toll switches that provide access to the terminating network. These networks are often owned by government bodies or telecommunications carriers who charge settlement rates well in excess of costs. Although these fees are being reduced in many countries as industry deregulation continues, these charges remain significant. Calls routed over the Internet can often bypass the toll switches, avoiding a significant portion of these fees, which further lowers the cost of completing such calls.
- *Positioning for New Services.* In contrast to the closed, proprietary structure inherent in a traditional circuit-switched voice network, VoIP embraces an open architecture and open standards, which facilitates innovation at a lower cost. Traditional voice networks have been designed specifically to provide one basic service, making it difficult and costly to introduce new services over those networks and their proprietary platforms. As data networks convert all services into standard data packets, new services are delivered from industry standard servers, integrating the Internet with the revolution in commodity computing. As a result, new services can be developed and brought to market much faster and more cost-efficiently.

*Outsourcing International Voice.* Given the advantages of VoIP, many carriers have announced plans to migrate to IP and have begun to carry some portion of their voice traffic over IP networks. However, most such projects are focused on domestic infrastructure only, where the investment may not only reduce cost of voice services but will also enable the development of innovative high margin services. Most carriers' international voice business has not achieved sufficient scale to justify the capital investment required to deploy a new international IP network for voice. Lacking necessary scale to achieve the required efficiency and unable to justify an investment in new lower cost infrastructure, carriers are exploring the outsourcing of international traffic to providers such as iBasis. The reasons these carriers prefer to outsource international traffic include:

- the relatively low percentage of revenue and gross profit that international service represents for many large carriers;



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- the disproportionate cost and complexity of deploying and supporting international service infrastructure in contrast with domestic investment opportunities;
- a hesitation to build new networks and cannibalize traffic from their traditional voice networks;
- concerns over sufficient in-house VoIP expertise to ensure that voice quality and network reliability are comparable to that of the public-switched telephone network, especially when routing traffic over the Internet versus private networks; and
- generally reduced capital budgets for network investments of any kind.

## **Wholesale Trading Business**

Our wholesale Trading business enables carriers and other communications service providers to outsource international voice and fax traffic, substantially lowering their transport and service support costs, without compromising quality. Our carrier customers access The iBasis Network by establishing an interconnection through one of our "Internet central offices" or "ICOs" strategically located in major telecommunications hubs in the U.S., Asia, and Europe. Calls are transported over the Internet, or over TDM connections, and terminated by our terminating partners—fixed and mobile operators—in more than 100 countries. In this way, our originating customers receive a single point of interconnection to a global network of termination points without the burden of managing the international network logistics and interconnection agreements on the far end. Likewise, our partners, who sell us termination capacity in their countries, receive a substantial source of traffic revenue without having to negotiate individual agreements and interconnections with originating carriers. Our services provide the following key benefits to our customers:

*High Quality Call Completion.* Our network, monitoring and management technologies enable us to complete international voice and fax calls with quality comparable to that of traditional circuit-switched voice networks. This high quality is reflected in the fact that carriers choose to provide our VoIP services to their retail customers undifferentiated from their traditional services. We achieve high quality over the Internet through a variety of controls and technologies. At our 24x7, expert-staffed global Network Operations Centers ("NOCs") in Burlington, Massachusetts, Amsterdam, and Hong Kong, we are able to monitor our carrier customers' voice traffic. Using our patent-pending Assured Quality Routing® and PathEngine™ technologies to select optimal routing choices according to real time performance data, we dynamically route customers' traffic over multiple Internet routes, completing calls on our partners' phone networks in destination countries.

*Cost Effective Services.* We are able to maintain one of the lowest cost structures in the international voice industry because of our very large scale, which provides efficiencies and leverage when negotiating termination rates. Also, our call transport costs are lower because packet switching is more efficient than traditional circuit-switching. Because we use the Internet, rather than a private IP network, to deliver much of our international voice traffic, we have greater infrastructure flexibility and lower capital costs than service providers that employ dedicated point-to-point connections. VoIP equipment is less costly and incurs lower facilities costs (due to its smaller physical footprint) than equivalent capacity circuit-switched equipment. We offer an open, scalable architecture that enables carriers and communications service providers to connect quickly and without investment or technical expertise. We are also able to bypass many of the international settlement rates associated with some international traffic carried over circuit-switched voice networks, which produces additional cost savings.

## ***Outsourcing Revenue***

Our Outsourcing revenue currently consists of international voice traffic we terminate for Royal KPN and its affiliates (KPN Mobile, Telfort, E-Plus and Base) and for TDC, the leading telecommunications carrier in Denmark. We are a preferred supplier of mobile services for Royal KPN



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and its affiliates and we are the exclusive provider for international direct dialing, ISDN and Inmarsat services for all international telephone and fax traffic originating from or carried over the Royal KPN fixed network.

Pursuant to the TDC Transaction, we became the exclusive provider of international voice services for TDC under a five-year strategic outsourcing arrangement, and TDC became a preferred partner for terminating traffic sent by us into the Nordic region, consisting of Denmark, Finland, Iceland, Norway and Sweden. Approximately 130 non-Nordic international wholesale voice customers, as well as all of TDC' interconnection and bilateral agreements for inbound and outbound international phone calls were transferred to us. TDC retained its Nordic customer base and its pan-Nordic reach.

### **Retail Business**

Our Retail business consists primarily of our prepaid calling card services and Pingo, our prepaid calling service sold directly to consumers through an Internet website. Our prepaid calling card business leverages our global VoIP network and back-office systems, including a sophisticated prepaid rating and billing platform. We sell more than 200 brands of retail prepaid calling cards through established distributors to retail outlets in major metropolitan markets across the U.S. Many of the calling card brands are owned (trademarked) by us and feature our component branding, "Quality Calls from iBasis", on the cards. We also enable established carriers to leverage the strength of their brands by taking advantage of our prepaid calling card platform, production and distribution. The Oi brand calling card from Brazilian carrier Telemar is one example. We have established a dedicated operation to sell and service our prepaid retail calling card services. Typically, our Retail business delivers higher gross margins and has a faster cash collection cycle than our Trading business.

In September 2004, we launched Pingo®, our retail calling service offered directly to consumers and businesses through our eCommerce web interface. Pingo customers in the United States and 35 additional countries use credit cards or alternative web-based payment methods, such as PayPal® to purchase calling time over The iBasis Network. Customers are provided with toll-free or local access numbers, a unique account number and a personal identification number to access the service. Pingo's enhanced convenience features include access to on-line call and billing history, automatic recharging to maintain a balance in the customer's Pingo account, and PIN<sup>pass</sup>™ PIN-less dialing, which enables a customer to avoid keying in their account number and PIN when calling from any fixed or mobile phone they have registered on the Pingo site. These features are designed to increase the customer's convenience and loyalty to the service. In 2007, we launched PingoBusiness, which features enhancements that enable businesses to manage multiple Pingo accounts through a single administrative account.

Our Retail services build upon the underlying iBasis network and systems and give us opportunities to capture retail traffic directly from consumers, which may provide higher margins than traffic received through other carriers. In offering these services, we can take advantage of our high quality call completion and cost effective services.

### **The iBasis Network**

#### ***Overview***

We transported 23.5 billion minutes of traffic over the iBasis Network in 2008, a volume of traffic that positions us among the three largest carriers of international traffic in the world, based on global traffic statistics contained in the industry analyst publication TeleGeography 2009.

The iBasis network is comprised of a global VoIP infrastructure, which is the legacy iBasis network, and an international TDM infrastructure, which is the legacy KPN GCS network.

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Our VoIP infrastructure includes Internet Central Offices ("ICO") located in the major telecommunications markets around the world—New York, Los Angeles, Amsterdam, London, Frankfurt, Paris, Hong Kong, Tokyo, and Sydney—and more than 1,000 Internet Branch Offices ("IBO") located in the facilities of termination partners in more than 100 countries. Each ICO includes high capacity gateways, routers, session border controllers, and multiple IP backbone connections. Carrier customers send traffic to us by interconnecting via TDM or IP to one or more of the ICOs. Their calls are then sent as VoIP from the iBasis ICO to a termination partner's IBO over the Internet. Some traffic is sent to third-party providers whom we use to supplement our direct routes.

Our TDM infrastructure uses ICOs containing TDM switches in Amsterdam, Rotterdam, Frankfurt and New York connected to a network of termination partners via the Public Switched Telephone Network ("PSTN"). Customers can connect directly to the TDM ICOs or through our Transmission Points of Presence ("PoP") in Miami, Hong Kong and Singapore, or through many more Euro-Ring PoPs owned by KPN. Traffic is transported from Transmission PoPs to ICOs via the PSTN.

Today, our VoIP and TDM networks are combined through a high capacity connection that enables traffic originating on either side to terminate with a supplier connected to the other side if that supplier offers us lower costs and acceptable quality. As a result, an interconnection to one network gives iBasis customers access to both. For example, calls that come in to the TDM infrastructure can be terminated over the VoIP infrastructure. The VoIP network is primarily managed through our NOCs in Burlington, Massachusetts and Hong Kong, and the TDM network is managed through our NOC in Hilversum, The Netherlands.

During the second half of 2008, we began the process of converting a number of our customers from our TDM network to our all-IP network. Over the next three to five years we intend to convert our remaining customers from our TDM network to our all-IP network. This will enable us to take full advantage of the superior cost efficiencies of VoIP and is an additional source of synergies we expect from the transaction with KPN.

### ***iBasis VoIP Leadership***

The iBasis VoIP network is based on a technologically-advanced switchless architecture, leveraging proven hardware from industry leaders such as Cisco Systems and GenBand (formerly NexTone and NextPoint), as well as patented and patent-pending iBasis software for quality management and advanced routing. Our Assured Quality Routing and PathEngine technology enables ongoing monitoring of network performance and automatic selection of best quality routes based on near real-time performance data. The switchless architecture provides us with significant savings in operational costs and capital expense by eliminating the need for costly telecommunications switches and other equipment and connectivity in central offices. It also has enabled us to simplify provisioning, real-time route monitoring, and network management by decreasing the number of network components involved in carrying a call. The result for our customers is higher voice quality, call completion and call duration.

We have deployed specialized transcoding equipment that enables our network to accept traffic in a wider variety of formats associated with codecs—compression/decompression algorithms used by consumer VoIP providers to support different devices, applications and networks. As part of our DirectVoIP™ Broadband offering, the transcoding solution gives iBasis an advantage in meeting the interoperability requirements of emerging service providers.

The iBasis Network consists of four principal elements:

- Internet Central Offices and Internet Branch Offices that convert circuit-switched voice traffic into data for transmission and reception over the Internet or vice versa;
- the transmission medium, which is principally the public Internet;

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- Assured Quality Routing and PathEngine technology, our proprietary traffic monitoring and routing management software; and
- our Network Operations Centers, from which we oversee and coordinate the operation of the ICOs and IBOs.

*Internet Central Offices and Internet Branch Offices.* Our customers interconnect with our network, at their cost, by connecting dedicated voice circuits from their facilities to one of our ICOs, which are strategically located in Amsterdam, Frankfurt, Hong Kong, London, Los Angeles, New York, Paris, Sydney and Tokyo. Alternatively, our customers may elect to install an iBasis IBO at their facilities. ICOs and IBOs receive calls directly from a local carrier's switched network. VoIP gateways in each ICO or IBO digitize, compress and packetize voice and fax calls and then transmit them over the Internet. At the destination, another ICO or IBO reverses the process and the call is switched back from the Internet to a local carrier's circuit-switched network in the destination country. Increasingly, customers are investing in VoIP equipment and connecting to us using an IP signal. As this trend progresses, our already asset-effective business model gains further strength. We no longer bear all the cost of converting calls between traditional voice network and the Internet, and dedicated physical circuit-switched interconnects are eliminated altogether.

*The Internet.* We use the Internet to transmit the majority of our voice and fax traffic because of its global coverage, low cost and flexible connectivity. As a result, we have avoided the expense and delay of deploying and maintaining a private, dedicated network of fiber and cable connections. In addition, because we do not have fixed, point-to-point connections, we can adapt to changes in international traffic flows rapidly and at minimal cost. We effectively address the challenges of using the Internet for high quality, real-time voice communications by:

- selecting only high quality, service-oriented Internet service providers as our vendors;
- purchasing multiple, high-speed connections into the Internet backbone; and
- continuously monitoring performance across our entire network.

*Assured Quality Routing.* We have deployed a proprietary patent-pending system of tools—collectively known as Assured Quality Routing to maintain high quality service over the Internet. AQR optimizes the quality of calls placed over The iBasis Network by integrating quality parameters into routing decisions. These parameters include measures of quality that are of direct importance to carriers including call duration, call completion and post-dial delay as well as underlying determinants of successful data transmission, namely packet loss, jitter and latency. Utilizing data collected in near real-time by our patented PathEngine performance reporting technology, AQR automatically re-routes traffic in anticipation of quality dropping below specific thresholds, sending subsequent calls through another Internet path, to an alternative terminating IP partner or to a circuit-switched backup vendor if necessary.

*Global Network Operations Centers.* We manage our network and implement AQR through our network operations centers ("NOCs"). Our NOCs use leading network management tools from Hewlett-Packard and a number of other vendors, which are integrated with our AQR systems to enable us to monitor, test and diagnose all components of The iBasis Network. NOCs in Burlington, Massachusetts, Hilversum, The Netherlands and Hong Kong are staffed by network and traffic engineers to provide expert coverage 7 days a week, 24 hours a day, 365 days a year, and are equipped with:

- tools that support the monitoring and analysis of various components of The iBasis Network to identify and address potential network problems before they affect our customers;
- system redundancy, including power back-up; and
- a help desk that allows us to respond quickly to our customers' needs and concerns.

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### **Engineering and Network Operations**

Our engineering and network operations activities are primarily focused on developing, improving and expanding The iBasis VoIP Network and increasing the efficiency of our interconnections with buyers and sellers of telecommunications services. These activities include the development of specific tools for our networks, such as our patent-pending Assured Quality Routing and patented PathEngine technologies, as well as specialized interconnection technologies like our DirectVoIP Broadband service, which is designed to meet the needs of providers of consumer VoIP services. In addition, our engineering personnel contribute to the support and operation of our global network operations centers, which oversee and coordinate the operation of our ICOs and IBOs. Engineering and network operations activities for the support of our TDM network has to-date been provided by KPN under a service level agreement.

### **Markets and Customers**

According to TeleGeography, the global market for international phone service was estimated to be approximately a \$78 billion market in 2007 and international voice minutes grew 14% from 2006 to 2007. As a subset, international VoIP traffic grew 28% in that same period to approximately 78 billion minutes. The portion of international traffic carried by wholesalers like us grew 17% over the same period as more carriers turned to wholesalers to handle their international business. In all but two of the 16 years from 1992 to 2007 the rate of increase in traffic volume has outstripped the rate of decline in pricing, providing the opportunity for continued revenue growth. With the increasing migration of international traffic to VoIP and the growth in calls that are originating as IP through incumbent and emerging providers, including cable operators, growth of international VoIP traffic is likely to continue. This reinforces the growth opportunities for us, as it is natural for providers who are originating their traffic on IP to turn to VoIP carriers, like us, to avoid unnecessary conversions to TDM to complete their international calls.

As of December 31, 2008, we provided services to approximately 800 carriers worldwide. Other than revenue from Royal KPN and its affiliates, no one carrier accounted for 10% or more of revenue in 2008, 2007 or 2006. For further discussion of geographic revenues, refer to Note 5 in our Notes to Consolidated Financial Statements.

In countries where we terminate our traffic, we have established relationships with large national carriers and other local service providers that have strong local market expertise and relationships.

Increasingly, traffic flows are becoming reciprocal—formerly distinct customers and suppliers are becoming "trading-partners"—as deregulation and competition erode the distinction between the business models of our customers and suppliers. We expect continued growth in both size and profitability as this trend progresses and we further consolidate our position as a leading carrier that interconnects the world's local service providers.

Deregulation and increased competition in the telecommunications industry has caused prices for long distance telephone services to steadily decline, particularly in the U.S. and Western Europe. Regulatory pressure on mobile operators, particularly in the European Union, are lowering mobile termination rates. As a wholesale provider of long distance telephone services, our margins in this business reflect the effect of these lower prices. We attempt to offset the effect of these lower prices by negotiating lower costs from our call termination partners and by increasing the cost efficiency and utilization of our network. We have implemented a strategy to leverage retail traffic originating from both our Trading customers and our own Retail services to attempt to drive higher margins than we might typically realize from our Trading business. With our prepaid calling cards and Pingo, we are able to charge per-minute rates that can exceed our wholesale long distance rates, as well as generate revenue from fees typically associated with the use of prepaid services.

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**Sales and Marketing**

***Trading***

*Sales Strategy.* Our sales efforts for the wholesale Trading business target leading fixed line and wireless telecommunications carriers globally as both buyers of international minutes and sellers of termination capacity, as well as emerging providers of consumer VoIP services over broadband connections. Our sales force is comprised of experienced personnel with well-established relationships in the telecommunications industry, based in key markets worldwide and typically responsible for business development in a small number of countries regionally. Our sales process often involves a test of our services by potential originating customers in which they route traffic over our network to a particular country. Our experience to date has been that once a carrier has begun to use our network for a single country and finds our quality to be acceptable, the sales process for increasing the volume of traffic they send to us and increasing the number of destinations for which they use our network becomes incrementally easier. We also seek to cultivate relationships with service providers that can terminate the local leg of international calls. Our country managers actively pursue connections with capable termination partners in their regions. Our ability to deliver a high volume of traffic, due to our interconnections with more than 800 carriers with international minutes, makes us an attractive potential partner for local service providers.

After the closing of the KPN Transaction, we trained our sales people on the Company's total product portfolio to enable our sales personnel to be able to sell all of our products.

As deregulation and competition push all local service providers to both originate and terminate as much traffic as possible on their local networks, we believe we will increasingly enjoy "reciprocal" relationships with the providers with which we do business, further improving sales productivity.

We have offices providing sales coverage in Europe, Africa, the Middle East, Latin America, the Asia-Pacific region, and North America.

*Marketing Strategy.* In our wholesale Trading business, we seek to attract termination partners as well as customers and therefore address our marketing efforts to both. A very large portion of retail origination continues to be controlled by large incumbent retail carriers. We believe that we have largely achieved our primary marketing objectives of awareness and acceptance among incumbent retail carriers, as evidenced by our penetration of these carriers in the major developed regions of the world. We continue to reinforce our brand presence with incumbent retail carriers to help increase our share of international traffic. We also concentrate on state-owned carriers, known as PTTs, in Asia and in developing economies generally, who we view as natural customers. In addition, we have focused marketing efforts on raising awareness of our business among emerging consumer VoIP companies, cable operators, prepaid calling card providers, and mobile operators, which represent significant growth opportunities for us.

While we increasingly expect our customers to also be our termination partners, local circumstances in many countries still are such that we also look to partner with ISPs, new Competitive Local Exchange Carriers ("CLECs") and specialist termination providers, many of which are start-ups formed specifically to terminate international traffic. Connecting with multiple terminating providers in a given destination provides us with greater capacity and leverage in negotiations to reduce costs.

Our marketing activities include sponsoring, exhibiting and presenting at industry trade shows and conferences, media and industry analyst relations, a comprehensive website, and regular communications with our existing customer base.

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### ***Retail***

Our sales and marketing strategy for our Retail services business differs for the disposable prepaid calling card business and the Pingo eCommerce business. For the calling card business, we are focused on the following areas:

- expanding the portfolio of iBasis-branded calling cards;
- increasing our share of existing distributors' business and cultivating new distributors;
- expanding gross margins; and
- enhancing quality.

In developing our own calling card brands, in addition to supporting established brands of our distributors, we are building the presence of select brands in multiple markets across multiple distributors. These brands leverage a common rate and fee structure and are able to leverage common design and advertising, which enhances both administrative and marketing efficiency while building distributor and customer loyalty.

In late 2007, we launched the iBasis TruePrompts™ campaign, which we believe enhanced consumers' trust in our prepaid calling cards by guaranteeing delivery of the minutes advertised or prompted on each call. In 2008, we believe TruePrompts temporarily slowed our growth in Retail as not all competitors throughout the segment implemented similar measures as we did. As a result, it may have appeared to less sophisticated consumers that iBasis provided fewer minutes on its calling cards when compared to a competitor's calling card. In the future, we believe that clear disclosure and greater transparency in pricing are positive developments for the prepaid calling card industry overall and in particular for us as they will enhance the competitive advantage of our lower cost structure.

To broaden our calling card distribution we identify the leading established distributors in major urban markets in the U.S. and work to establish mutually beneficial relationships. These distributors possess the local market knowledge and relationships with retail outlets required to effectively build market presence for our calling cards. Some of our distributors operate as master distributors supporting smaller sub-distributors that help to broaden and reinforce their market share within various territories or types of outlets. We expand distribution into new ethnic and geographic markets by leveraging existing relationships and by pursuing new distributors as necessary. Expanding gross margins in the prepaid calling card business is a function of managing card lifecycles. Typically, new cards are introduced with very aggressive promotional pricing to build distributor and retailer enthusiasm and consumer interest. Once the card has proven its quality and reliability we move beyond the promotional stage into production, enabling us to realize higher margins. As we establish our presence in the calling card market, the overall age of our product portfolio will increase, essentially resulting in more products having graduated from the promotional phase into producing higher margins.

The sales and marketing strategy for our Pingo service leverages the cost-efficiency and tracking capabilities of on-line paid placement advertising on major search engines, such as Google and Yahoo, as well as opportunistic online banner advertising and editorial placement, particularly on ethnic and travel-oriented websites, and occasional print advertising in well-targeted publications. We also drive business through a web-based affiliate sales program, and promotion of free trial cards at events and through distribution partners. In addition, we leverage search engine optimization techniques on the Pingo.com website to maximize natural search results. We have retained a search engine marketing firm and an online creative firm with specific expertise and proprietary technology designed to optimize our online advertising investments. When prospects visit the Pingo website, we utilize special bonus awards and promotions to encourage initial purchase. We also maintain communication with our existing Pingo customers through frequent email announcements to encourage use of the service, recharges, and referrals, as well as provide rewards for their loyalty.



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### **Strategic Technology Relationships**

Strategic technology relationships are important because they give us early access to new technologies, a voice in the vendors' development direction and because strategic partners engage with us in support of our sales and marketing programs.

The iBasis Network is a Cisco Powered™ network and we have continued to maintain a strong technology and business relationship with Cisco Systems. This designation means that The iBasis Network is built predominantly with Cisco products and technologies and meets a high standard of reliability and performance. As a Cisco Powered™ network, we have enhanced access to Cisco technical resources and are able to more quickly deliver new capabilities and service features. We also have formed relationships with GenBand (formerly NexTone and NextPoint), a leading provider of session border controllers, which are deployed in our ICOs and provide interoperability and protocol conversion capabilities, and with Digium, the supplier of our transcoding platform, which is deployed as part of our DirectVoIP Broadband offering.

### **Competition**

We compete in two markets: international voice termination services, which we sell on a wholesale basis to other carriers, and retail prepaid calling services which we sell to consumers directly and through distributors. As described more completely in Item 1A "Risk Factors," the market for voice services is highly competitive. We compete with other wholesale trading carriers worldwide. Many of these carriers have more resources, longer operating histories and more established positions in the communications marketplace, and, in some cases, have begun to develop VoIP capabilities. We also compete with smaller companies, including those that may be specialists in just one or two routes. We compete with our own customers, including retail carriers who develop their own international networks or interconnect with one another and exchange international traffic by "meeting" in a major telecom hub. We compete principally on quality of service and price. In the overall international long distance market, which was approximately 343 billion minutes in 2007, based on current information, we are among the three largest carriers with approximately 7% market share.

In the retail prepaid calling card business, we compete with major telecommunications carriers and many smaller telecommunications providers. Many of our competitors have a longer operating history and a more established market presence in the retail prepaid calling card business than we do. Also, many of these competitors have greater resources. Our Pingo business competes with other on-line sellers of prepaid calling cards and services. Many of these operate on-line catalogs, selling the same cards that are available in physical form in retail stores. Because we terminate our retail traffic on our own VoIP network, we believe we enjoy a competitive advantage over the majority of competing calling card companies and online retailers.

Although the market for wholesale international traffic and retail prepaid calling services is highly competitive and will almost certainly remain so, we believe that our scale, comprehensive voice product portfolio, global footprint, sophisticated and automated back-office systems, and our patent-pending ability to manage traffic across the low-cost Internet while maintaining required quality, collectively represent a competitive advantage that will allow us to expand both volume and margins.

### **Government Regulation**

As more fully described in Item 1A "Risk Factors," our business is subject to U.S. and foreign laws, which may include those relating to telecommunications.

We hold a license to provide interstate and international telecommunications services from the Federal Communications Commission ("FCC") and we have obtained or are in the process of obtaining appropriate regulatory authority, and filing appropriate tariffs, regarding the Retail business

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in certain states. Additional aspects of our operations may currently be, or become, subject to state or federal regulations governing licensing, universal service funding ("USF"), advertising, disclosure of confidential communications or other information, excise taxes, U.S. embargos and other reporting or compliance requirements.

While the FCC has maintained that information service providers, including VoIP providers, are not telecommunications carriers for regulatory purposes, various entities have challenged this premise, both before the FCC and at various state government agencies. The FCC has ruled that certain communications carried in part utilizing the IP format, including prepaid calling card services such as those we provide, are regulated telecommunications services for which certain regulatory obligations, such as federal USF payments and access charge payments, apply. The FCC is presiding over several proceedings related to VoIP services and the extent that IP capabilities insulate such offerings from traditional regulation such as access charges, universal service, and interconnection rights for VoIP providers. Adverse rulings or rulemakings could subject us to licensing and reporting requirements and additional fees and charges.

The regulatory treatment of VoIP and other iBasis services varies widely among other countries and is subject to constant change. Until recently, most countries did not have regulations addressing VoIP or other VoIP services such as calling cards, in some cases classifying these services as unregulated services. As the VoIP market has grown and matured, increasing numbers of regulators have begun to reconsider whether to regulate VoIP and other VoIP services. Some countries currently impose little or no regulation on VoIP or VoIP services. Conversely, other countries that prohibit or limit competition for traditional voice telephony services generally do not permit Internet telephony or VoIP services or strictly limit the terms under which such services may be provided, even imposing criminal penalties for individuals associated with such offerings. Still other countries regulate VoIP and VoIP services like traditional voice telephony services, requiring VoIP companies to obtain licenses, incorporate local subsidiaries, make universal service contributions and pay other taxes.

We have advocated and supported deregulation for free and open market competition in a variety of countries.

## **Intellectual Property**

We regard our copyrights, service marks, trademarks, trade dress, trade secrets, patents, patent applications and similar intellectual property as critical to our success and we rely on trademark and copyright law, trade secret protection and confidentiality and/or license agreements with our employees, customers, partners, and others to protect our proprietary rights. Our policy is to seek patent protection of the technology, inventions and improvements that we consider important to the development of our business. In March 2008, we were granted our first patent for our methods of monitoring the quality of various routes to send calls through the Internet, PathEngine. As of December 31, 2008, we had several pending U.S. patent applications for The iBasis Network and other inventions related to our business. We have also entered into a licensing arrangement with Royal KPN granting us rights to Royal KPN' portfolio of patents, and Royal KPN has been granted a cross-license to our patent portfolio. We pursue the registration of our trademarks and service marks in the United States and overseas. We have been granted trademark registration for various marks related to our business, including *iBasis*, *Pingo*, *Assured Quality Routing*, *PremiumCertified*, *The last calling card you'll ever need!*, and several marks related to our prepaid calling card products in the United States, and the European community. In addition, we have pending registration applications for other service marks. We also rely on trade secrets, technical know-how and continuing innovation to develop and maintain our competitive position. We have granted licenses in the ordinary course of business for occasional use of our name, logo, trademarks and/or service marks to certain marketing partners pursuant to joint marketing and/or other agreements. Likewise, we have been granted certain licenses for use in the ordinary course of business.



[Table of Contents](#)**Employees**

As of December 31, 2008, we employed 372 people. Our employees are not represented by a labor union, except that approximately 70 employees of KPN GCS are subject to the Royal KPN Collective Labor Agreement.

**Geographic Areas**

For financial information about geographic areas, see Note 5, "Business Segment and Geographic Information" to our Consolidated Financial Statements.

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**Item 1A. Risk Factors**

*Any investment in our common stock involves a high degree of risk. You should carefully consider the risks described below together with the information contained elsewhere in this report, before you make a decision to invest in our company.*

**Factors That May Affect Future Results and Financial Condition**

***Risks Related to our Historical Stock Option Granting Practices***

**The investigation by the SEC has had, and may continue to have, a material adverse effect on us. We cannot predict the outcome of the SEC's formal investigation of our past stock option granting practices. The investigation has required, and may continue to require, significant management time and attention, as well as additional accounting and legal expense, and could result in civil and/or criminal actions seeking, among other things, injunctive and monetary relief from us.**

We announced on October 20, 2006, that we were contacted by the SEC as part of an informal inquiry and we further disclosed on March 29, 2007, on our Current Report on Form 8-K, that the SEC had notified us that we would be receiving a formal order of investigation relating to our stock option practices. On April 13, 2007, we received the formal order of investigation. The SEC investigation sought documents and information from us relating to the grant of our options from 1999 through 2006. The SEC has taken testimony from individuals including certain of our current and former officers and directors. We have cooperated fully with the SEC investigation and we are in communication with the SEC staff regarding the outcome of the investigation. There is no assurance that we will be able to resolve the SEC investigation on acceptable terms without the institution of enforcement proceedings by the SEC against us or one or more of our senior executive officers or that other inquiries will not be commenced by other U.S. federal, state or other regulatory agencies. An SEC enforcement proceeding could seek an injunction against future violations of the securities laws, a civil penalty and, as to individual executives, disgorgement and a bar order against serving as an officer or director of a publicly traded company. A bar order as to any of our senior executive officers would deprive us of any such executive's services and could have a material adverse effect on our business.

The SEC investigation and requests for information have required significant management attention and resources. The period of time necessary to resolve the SEC investigation is uncertain, and these matters could require significant additional attention and resources which could otherwise be devoted to the operation of our business. We have incurred substantial expenses with third parties for legal, accounting, tax and other professional services in connection with these matters and expect to continue to incur significant expenses in the future, which may adversely affect our results of operations and cash flows.

**Following the Special Committee investigation, two derivative civil action lawsuits were brought, purportedly on our behalf, which have required and may continue to require significant management time and attention and result in significant legal expenses and may result in an unfavorable outcome against our management, which could require us to pay substantial judgments or settlements pursuant to any indemnification obligations that we may have with them, and which could have a material adverse effect on our business, financial condition and results of operations.**

Following the Special Committee investigation, two derivative civil claims were filed, purportedly on our behalf, against certain of our current and former officers and directors. The suits were consolidated into a single suit on June 15, 2007, alleging violations of Section 14(a) of the Securities Exchange Act of 1934 and Section 304 of the Sarbanes Oxley Act of 2002 (SOX) and raising state law claims including unjust enrichment, breaches of fiduciary trust and waste of corporate assets. The court dismissed the case in December 2007, holding that the plaintiffs failed to assert viable federal claims under either Section 14(a) or SOX Section 304. The court also dismissed the remaining state law claims

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on jurisdictional grounds. Plaintiffs filed a motion for reconsideration in late December 2007 which has been denied. Although plaintiffs filed an appeal of the denial of reconsideration, the appeal was dismissed, on plaintiffs' motion, on February 18, 2009. Plaintiffs could still re-file the state law claims in state court or in federal court asserting diversity jurisdiction.

The amount of time to resolve any lawsuits or other proceedings related to our past option granting practices is unpredictable, and in defending themselves, our management's attention may be diverted from the day-to-day operations of our business, which could adversely affect our business, financial condition and results of operations. In addition, an unfavorable outcome of such litigation could require us to incur significant legal expenses and substantial judgments or settlements pursuant to any indemnification obligations that we may have with our officers and directors, which could also have a material adverse effect on our business, financial position, results of operations or cash flows.

Our insurance coverage may not be sufficient to cover our total liabilities in any such actions if we are obligated to indemnify (and advance legal expenses to) former or current directors or officers in accordance with the terms of our certificate of incorporation, bylaws, other applicable agreements, and Delaware law. We currently hold insurance policies for the benefit of our directors and officers, although our insurance coverage may not be sufficient in either of these matters. Furthermore, the underwriters of our directors and officer's insurance policy may seek to rescind or otherwise deny coverage in some or all of these matters, in which case we may have to self-fund the indemnification amounts owed to such directors and officers.

### ***Risks Related to Our Business***

#### **Political and economic conditions and the current financial crisis in the U.S. and global capital and credit markets may adversely affect our revenue and results of operations and overall financial growth.**

Our business can be affected by a number of factors that are beyond our control such as general geopolitical economic and business conditions, conditions in the financial services markets, and general political and economic developments. Recent turmoil in the U.S. financial markets, the present economic slowdown and the uncertainty over the breadth, depth and duration of the slowdown may continue to adversely impact the global economy and have a negative effect on our business. In particular, a decline in traffic from migrant workers using prepaid calling cards has undermined and may continue to undermine our Trading and Retail businesses.

Further, the recent worldwide financial and credit crisis has reduced the availability of liquidity and credit to fund the continuation and expansion of business operations worldwide. The shortage of liquidity and credit combined with recent substantial losses in worldwide equity markets could lead to an extended economic recession in the United States or worldwide. As widely reported, financial markets in the United States, Europe and Asia have been experiencing extreme disruption in recent months, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades of certain investments and declining valuations of others. Governments have taken unprecedented actions to stimulate their local economies and address extreme market conditions that include severely restricted credit and declines in real estate values. While this challenging economic environment has not yet impaired our ability to access credit markets and finance our operations, there can be no assurance that the deterioration in financial markets will not impair our ability to obtain financing in the future, including, but not limited to, our ability to draw on funds under our existing credit facilities and our ability to incur additional indebtedness. If conditions in the global economy, U.S. economy or other key vertical or geographic markets remain uncertain or weaken further, we could experience material effects on our business, financial condition, results of operations, cash flow, capital resources and liquidity.

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### **Our results of operations may fluctuate and the market price of our common stock may fall.**

Our revenue and results of operations have fluctuated and will continue to fluctuate significantly from quarter to quarter in the future due to a number of factors, some of which are not in our control, including, among others:

- the amount of traffic we are able to sell to our customers, and their decisions on whether to route traffic over our network;
- increased competitive pricing pressure in the international long distance market from emerging and established integrated carriers some of which are much larger and have greater financial resources than we do;
- volatility in foreign exchange rates may reduce the competitiveness and profitability of some of our traffic flows where customers pay us in one currency and we pay terminating providers in another;
- the percentage of traffic that we are able to carry over the Internet rather than over the more costly traditional public-switched telephone network;
- the loss of arbitrage opportunities resulting from declines in international settlement rates or tariffs;
- our ability to negotiate lower termination fees charged by our local providers;
- our continuing ability to negotiate competitive costs to connect our network with those of other carriers and Internet backbone providers;
- fraudulently sent or received traffic which is unbillable, for which we may be liable;
- credit card fraud in connection with our web-based prepaid offering;
- capital expenditures required to expand or upgrade our network;
- changes in call volume among the countries to which we complete calls;
- the portion of our total traffic that we carry over more lucrative routes could decline, independent of route-specific price, cost or volume changes;
- technical difficulties or failures of our network systems or third party delays in expansion or provisioning system components;
- our ability to manage distribution arrangements and provision of retail offerings, including card printing, marketing, usage tracking, web-based offerings and customer service requirements, and resolution of associated disputes;
- our ability to manage our traffic on a constant basis so that routes are profitable;
- our ability to collect from our customers;
- restrictions in countries where we operate; and
- potential impairment of our long-lived assets.

Because of these factors and others, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance. It is possible that, in future periods, our results of operations will be significantly lower than the estimates of public market analysts, investors or our own estimates. Such a discrepancy could cause the price

of our common stock to decline significantly and adversely affect our profitability.

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**We may not be able to generate sufficient revenue and gross profit to achieve our revenue and profitability goals in the long term if telecommunications carriers and other communications service providers are reluctant to use our services in sufficient volume.**

If the market for international wholesale VoIP telephony and new services does not develop as we expect, or develops more slowly than expected, our business, financial condition and results of operations will be materially and adversely affected.

Our customers may be reluctant to use our VoIP services for a number of reasons, including:

- perceptions that the quality of voice transmitted over the Internet is low;
- perceptions that VoIP is unreliable;
- our inability to deliver traffic over the Internet with significant cost advantages;
- development of their own capacity on routes served by us;
- an increase in termination costs of international calls;
- uncertainty regarding the regulatory status of VoIP services; and
- uncertainty regarding potential patent infringement related to certain VoIP services.

The growth of our core wholesale Trading business depends on carriers and other communications service providers generating an increased volume of international voice and fax traffic and selecting our network to carry at least some of this traffic. Similarly, the growth of Retail services we offer depends on these factors as well as acceptance in the market of the brands that we service, including their respective rates, terms and conditions.

**We may not be able to maintain our NASDAQ Global Market listing.**

**Our common stock is listed on the NASDAQ Global Market. There is no assurance that we will be able to satisfy the NASDAQ Global Market's continued listing standards, which includes, among others, a minimum per share sales price and a minimum market value of publicly held shares. In December 2008, NASDAQ announced the suspension of the rules requiring a minimum \$1 closing bid price per share and minimum market value of publicly held shares until April 20, 2009. On March 6, 2009, the closing price of our common stock was \$0.61 per share. If our common stock is delisted from the NASDAQ Global Market, we would be forced to list our common stock on the OTC Bulletin Board or some other quotation medium. Selling our common stock would be more difficult because smaller quantities of shares would likely be bought and sold and transactions could be delayed. These factors could result in lower prices and larger spreads in the bid and ask prices for shares of our common stock. If this happens, we will have greater difficulty accessing the capital markets to raise any additional necessary capital.**

**We may not be able to collect amounts due to us from our customers and we may have to disgorge amounts already paid.**

Some of our customers have closed their businesses or filed for bankruptcy while owing us significant amounts for services we have provided to them in the past. Despite our efforts to collect these overdue funds, we may never be paid. The bankruptcy court may require us to continue to provide services to these companies during their reorganizations. Other customers may discontinue their use of our services at any time and without notice, or delay payments that are owed to us. Additionally, we may have difficulty in collecting amounts from them. Although we have internal credit risk policies to identify companies with poor credit histories, we may not effectively manage these policies and may provide services to companies that refuse to pay. The risk is even greater in foreign countries, where the legal and collection systems available may not be adequate or impartial for us to



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enforce the payment provisions of our contracts. Our cash position will be reduced and our results of operations will be materially adversely affected if we are unable to collect amounts from our customers.

We have received claims including lawsuits from estates of bankrupt companies alleging that we received preferential payments prior to such companies' bankruptcy filing. We may be required to return amounts received from entities that subsequently become bankrupt. We intend to employ all available defenses in contesting such claims or, in the alternative settle such claims. The results of any suit or settlement may have a material adverse affect on results of operations.

### **We may not be able to obtain sufficient or cost-effective termination capacity to particular destinations.**

In order to support our growth and geographic expansion, we may need to obtain additional termination capacity or destinations. As the world becomes smaller and more closely knit due to advancements in speed and access due to advancements in communications industries, our ability to extend our reach beyond our competitors' to new or remote destinations is increasingly critical. We may not be able to obtain sufficient termination capacity from high-quality vendors to particular destinations or may have to pay significant amounts to obtain such capacity. A lack of sufficient or cost-effective termination capacity to certain destinations could result in our not being able to terminate all of the traffic we receive from our customers, or incur a higher cost-per-minute to terminate traffic to particular destinations, which could adversely affect our business.

### **We may increase costs and risks in our business to the extent we rely on third parties.**

*Vendors.* We rely upon third-party vendors to provide us with the equipment, software, circuits, and other facilities that we use to provide our services. For example, we purchase a substantial portion of our VoIP equipment from Cisco Systems. We may be forced to try to renegotiate terms with vendors for products or services that have become obsolete. Some vendors may be unwilling to renegotiate such contracts, which could affect our ability to continue to provide services and consequently render us unable to generate sufficient revenues for our business.

*Parties that Maintain Phone and Data Lines and Other Telecommunications Services.* Our business model depends on the availability of the public Internet and traditional telephone networks to transmit voice and fax calls. Third parties maintain and own these networks, other components that comprise the public Internet, and business relationships that allow telephone calls to be terminated over the public switched telephone network. Some of these third parties are telephone companies. They may increase their charges for using these lines at any time and thereby increase our expenses. They may also fail to maintain their lines properly, fail to maintain the ability to terminate calls, or otherwise disrupt our ability to provide service to our customers. Any such failure that leads to a material disruption of our ability to complete calls or provide other services could discourage our customers from using our network, which could adversely affect our results of operations.

*Local Communications Service Providers.* We maintain relationships with local communications service providers in many countries, some of whom own the equipment that translates calls from traditional voice networks to the Internet, and vice versa. We rely upon these third parties both to provide lines over which we complete calls and to increase their capacity when necessary as the volume of our traffic increases. There is a risk that these third parties may be slow, or may fail, to provide lines, which would affect our ability to complete calls to certain destinations. We may not be able to continue our relationships with these local service providers on acceptable terms, if at all. Because we rely upon entering into relationships with local service providers to expand into additional countries, we may not be able to increase the number of countries to which we provide service. Finally, any technical difficulties that these providers suffer, or difficulties in their relationships with companies that manage



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the public switched telephone network, could affect our ability to transmit calls to the countries that those providers help serve.

*Strategic Relationships.* We depend in part on our strategic relationships to expand our distribution channels and develop and market our services. Strategic relationship partners may choose not to renew existing arrangements on commercially acceptable terms, if at all. In general, if we lose these key strategic relationships, or if we fail to maintain or develop new relationships in the future, our ability to expand the scope and capacity of our network and services provided, and to maintain state-of-the-art technology, would be materially adversely affected.

*Distributors of prepaid calling cards to retail outlets.* We make arrangements with distributors to market and sell prepaid calling cards to retail outlets. In some cases, we rely on these distributors to print cards, prepare marketing material, activate accounts, track usage and other data, and remit payments collected from retailers or sub-distributors. There is a risk that distributors will not properly perform these responsibilities, comply with legal requirements, or pay us monies when due. We may not have adequate contractual or credit protections against these risks. There is also a risk that we will be ineffective in our efforts to implement new systems, policies covering customer care, disclosure, privacy, and certain technical and business processes. The result of any attendant difficulties may have a material impact on our business.

### **We may not be able to succeed in the intensely competitive market for our wholesale Trading services, prepaid calling and mobile operator enhanced services.**

We compete in our wholesale Trading business principally on quality of service and price. In recent years, prices for international long distance telephone services have been declining as a result of deregulation and increased competition. We face competition from the wholesale service operations of major telecommunications carriers, including AT&T, British Telecom, Deutsche Telekom, Verizon and Qwest, as well as new emerging carriers. We also compete with Internet protocol and other VoIP service providers who route traffic to destinations worldwide. VoIP service providers that presently focus on retail customers may in the future enter the wholesale market and compete with us. If we can not offer competitive prices and quality of service our business could be materially adversely affected.

The market for prepaid calling services is extremely competitive. Hundreds of providers offer calling card products and services. We have relatively recently begun offering prepaid calling card and related web-based services and have little prior experience in these businesses. Advertising and pricing practices by some providers in the prepaid calling card industry are aggressive and can be misleading which may put us at a competitive disadvantage. Many of our prepaid calling services are marketed primarily to immigrant communities. If changes in immigration policy or other factors, including general economic conditions cause a reduction in the foreign born population living in the U.S. our business may suffer. If we do not successfully maintain and expand our distribution channel and enter geographic markets in which our rates, fees, surcharges, country services, and our other products and service characteristics can successfully compete, our business could be materially adversely affected.

### **We are subject to downward pricing pressures and a continuing need to renegotiate overseas rates.**

As a result of numerous factors, including increased competition and global deregulation of telecommunications services, prices for international long distance calls have been decreasing. This downward trend of prices to end-users has caused us to lower the prices we charge communications service providers and calling card distributors for call completion on our network. If this downward pricing pressure continues, we may not be able to offer our VoIP services at costs lower than, or competitive with, the traditional voice network and VoIP services with which we compete. Moreover, in order for us to lower our prices, we have to renegotiate rates with our overseas local service providers who complete calls for us. We may not be able to renegotiate these terms favorably enough, or fast

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enough, to allow us to continue to offer services in a particular country on a cost-effective basis. The continued downward pressure on prices and our failure to renegotiate favorable terms in a particular country could have a material adverse effect on our ability to operate our network and business profitably.

### **A variety of risks associated with our international operations could materially adversely affect our business.**

Because we provide many of our services internationally, we are subject to additional risks related to operating in foreign countries. In particular, in order to provide services and operate facilities in some countries, we have established subsidiaries or other legal entities or may have forged relationships with service partners or entities set up by our employees. We also rely on our own employees to maintain certain functions of our Internet central offices and, in some cases, to deploy and operate our smaller points of presence installations. Associated risks include:

- uncertainty regarding or unexpected changes in tariffs, trade barriers and regulatory requirements relating to Internet access or VoIP;
- economic weakness, including inflation, or political instability in particular foreign economies and markets;
- difficulty in collecting accounts receivable;
- compliance with varying tax, consumer protection, telecommunications, and other laws;
- compliance with tax, employment, securities, immigration, labor and other laws for employees living and traveling, or conducting business, abroad, which may subject them or us to criminal or civil penalties;
- foreign currency fluctuations, which could result in increased operating expenses and reduced revenues;
- unreliable government power to protect our rights and those of our employees;
- exposure to liability under the Foreign Corrupt Practices Act or similar laws in foreign countries;
- other obligations or restrictions, including, but not limited to, criminal penalties against us or our employees incident to doing business or operating a subsidiary or other entity in another country;
- the personal safety of our employees and their families who at times have received threats of, or who may in any case be subject to, violence, and who may not be adequately protected by legal authorities or other means; and
- inadequate insurance coverage to address these risks.

These and other risks associated with our international operations may materially adversely affect our ability to maintain profitable operations.

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### **We may enter into strategic outsourcing transactions and undertake acquisitions or dispositions, or may be the target of similar strategic initiatives, that could be difficult to integrate or could damage our business.**

We may enter into strategic outsourcing transactions and acquire businesses and technologies in an attempt to complement or augment our existing businesses, services and technologies. The success of these transactions will depend, in part, on our ability to: identify suitable businesses and assets to buy; complete the transactions on terms acceptable to us and in the timeframes we expect; improve the financial results and operations of the businesses we buy; and avoid or overcome potential antitrust or other concerns expressed by regulators. We may also be subject to, or participate in, strategic activities by others that result in a transfer of control of our assets or control of our outstanding shares of stock. We may need to raise additional funds through public or private debt, equity financing or issue more shares to affect such activities, which may result in dilution for shareholders and the incurrence of indebtedness. We may have difficulty integrating any additional businesses into our existing business and the process of any acquisitions or subsequent integration could divert management's attention and expend our resources. We may not be able to operate acquired businesses profitably or otherwise implement our growth strategy successfully.

### **If we are unable to effectively integrate any new business into our overall business operations, our costs may increase and our business results may suffer significantly.**

We may need to sell existing assets or businesses in the future to generate cash or focus our efforts on making our core Trading business profitable. As with many companies in our sector that have experienced rapid growth in recent years, we may need to reach profitability in one market before entering another. In the future, we may need to sell assets to cut costs or generate liquidity.

### **If we are not able to keep up with rapid technological change in a cost-effective way, the relative quality of our services could suffer.**

The technology upon which our services depend is changing rapidly. Significant technological changes could render the hardware and software that we use obsolete, and competitors may begin to offer new services that we are unable to offer. If we are unable to respond successfully to these developments or do not respond in a cost-effective way, we may not be able to offer competitive services and our business results may suffer.

### **We may not be able to expand and upgrade our network adequately and cost-effectively to accommodate any future growth.**

Our business requires that we handle a large number of international calls simultaneously. As we expand our operations, we expect to handle significantly more calls. If we do not expand and upgrade our hardware and software quickly enough, we would not have sufficient capacity to handle the increased traffic and growth in our operating performance would suffer as a result. Even with such expansion, we may be unable to manage new deployments or utilize them in a cost-effective manner. In addition to lost growth opportunities, any such failure could adversely affect customer confidence in The iBasis Network and could result in us losing business.

### **We may not be able to maintain our routing, reporting, and billing systems and related databases adequately and cost-effectively to accommodate our continuing needs.**

Our business requires that we track enormous volumes of data so that we can manage traffic, and assess margin, revenue, and customer accounts. We constantly measure and upgrade our technical capabilities, and develop new tools to address our needs. If we do not maintain these systems or modify

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them in an appropriate manner, analyze service pricing methodologies effectively, or bill our customers properly, our business will be negatively affected.

### **Single points of failure on our network may make our business vulnerable.**

We operate three Network Operations Centers as well as numerous Internet central offices and other points of presence throughout the world. In some cases, we have designed redundant systems, provided for excess capacity, and taken other precautions against platform and network failures as well as facility failures relating to power, air conditioning, destruction, or theft. Nonetheless, some of our infrastructure and functionality, including those associated with certain components of our Retail business, operate as a single point of failure, meaning, failures of the type described may prohibit us from offering services at all at any given time. The potential of such a failure may discourage others from using our network, which may adversely impact our business.

### **We depend on our current personnel and may have difficulty attracting and retaining the skilled employees we need to execute our business plan.**

Our future success will depend, in large part, on the continued service of our key management and technical personnel. If any of these individuals or others we employ are unable or unwilling to continue in their present positions for any reason, including the outcome of the SEC investigation, our business, financial position, results of operations or cash flows could suffer. We do not carry key person life insurance on our personnel.

### **We will need to retain skilled personnel to execute our plans.**

Our future success will also depend on our ability to attract, retain and motivate highly skilled employees, particularly engineering and technical personnel. Recent reductions in our workforce, a temporary salary freeze and a freeze on new hiring instituted at the beginning of 2009 may make it difficult to motivate and retain employees and contractors, which could affect our ability to deliver our services in a timely fashion and otherwise negatively affect our business.

### **We cannot ensure that our existing capital will be sufficient to meet our requirements for the future and a failure to obtain necessary additional capital could jeopardize our operations.**

We may need additional capital in the future to fund our operations, finance investments in equipment and corporate infrastructure, expand our network, increase the range of services we offer and respond to competitive pressures and perceived opportunities. We may not be able to obtain additional financing on terms acceptable to us, if at all. If we raise additional funds by selling equity securities, the relative equity ownership of our existing investors could be diluted or the new investors could obtain terms more favorable than previous investors. A failure to obtain additional funding could prevent us from making expenditures that are needed to allow us to grow or maintain our operations.

### ***Risks Related to Regulatory Matters***

#### **The telecommunications industry is subject to domestic governmental regulation and legal uncertainties and other laws that could materially increase our costs and prevent us from executing our business plan.**

Under FCC rules, services classified as telecommunications services have been subject to regulation, whereas services classified as information or enhanced services have been largely exempt from regulation, including the requirement to pay access charges. We have taken the position that our wholesale Trading services are enhanced services that are exempt from traditional regulation that applies to telecommunications services. While the FCC has traditionally maintained that information service providers, including VoIP providers, do not provide telecommunications services for regulatory

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purposes, various entities have challenged this policy at the state and federal levels and the FCC has begun to regulate certain aspects of various types of VoIP services. For example, in 2004, the FCC concluded that long distance calls that begin and end as regular calls but use IP to transport some portion of the call are telecommunications services. As indicated above, the FCC also concluded that prepaid calling card services that utilize IP-transport are telecommunications services, not information services. However, in making this ruling the FCC did not clarify what intercarrier compensation payments are owed by the different carriers in the prepaid calling card context when long distance calls are made using local access. There has been increasing controversy over this issue. Some carriers have taken the position that the prepaid calling card providers that purchase these local numbers owe access charges over and above the amounts already paid to the provider that sells the access numbers. We believe that we are not responsible for any additional charges. There are pending proceedings at the FCC designed to clarify and resolve this issue. However, recent industry activity suggests that lawsuits could be initiated by certain carriers against prepaid calling card providers for recovery of arrearages of access charges prior to any clarification of the issue by the FCC. Accordingly, there is a risk of additional litigation associated with this issue. This intercarrier compensation controversy is also increasing the cost of local access numbers because many carriers that provide this service are increasing their rates to cover the costs and/or risks associated with providing the service to prepaid calling card providers in the event that they are found responsible for additional charges. These cost increases have materially increased the costs of our retail prepaid business.

Additionally, the FCC has issued a variety of orders that have imposed additional regulatory obligations on certain VoIP providers. For example, the FCC found that certain VoIP services that interconnect with the traditional public telephone network ("Interconnected VoIP Services") must begin making Universal Service Fund, or USF, contributions, provide 911 and Telecommunications Relay Services, comply with certain law enforcement intercept obligations, and also comply with other regulatory reporting requirements. To date, however, the agency has declined to determine whether Interconnected VoIP Service is a telecommunications service or an information service.

As a result of these and other rulings, aspects of our operations may currently be, or may become, subject to state or federal regulations governing licensing, USF funding, interstate or intrastate access charges, advertising, disclosure of confidential communications or other information, excise and other fees, taxes and surcharges, U.S. embargos and other reporting or compliance requirements.

We hold a license to provide interstate and international telecommunications services from the Federal Communications Commission ("FCC") and we have obtained or are in the process of obtaining appropriate regulatory authority, and filing appropriate tariffs, regarding the Retail business in certain states. Additional aspects of our operations may currently be, or become, subject to state or federal regulations governing licensing, universal service funding, advertising, disclosure of confidential communications or other information, excise taxes, U.S. embargos and other reporting or compliance requirements.

In the event of an audit from the federal Universal Service Administrator or complaint from a local exchange or local access provider, we could be subject to arrearages for USF contributions or access charges.

Although we believe that our interstate wholesale Trading products qualify as information services that are exempt from federal USF contributions, we have, as of January 1, 2005, reported our wholesale Trading revenues to the FCC as telecommunications revenues, while reserving our rights.

We have offered our prepaid international calling card services on a wholesale basis to international carrier customers, and others, some of which provide these services to end-user customers, enabling them to call internationally over the iBasis Network. We participate in selling and marketing of calling cards through a network of distributors on a retail basis. We also offer a web-based retail prepaid calling card offering. Although the calling cards are primarily used for international calling, we

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have not blocked the ability of users to place interstate and intrastate calls and we have not in every instance required our wholesale customers or distributors to provide evidence of their compliance with U.S. and state regulations.

The Federal Telecommunications Act of 1996 requires that payphone service providers be compensated for all completed calls originating from payphones in the United States. The FCC's rules require the last switched-based carrier to compensate payphone providers, and further require that all carriers in the call chain implement a call-tracking system, utilize it to identify such calls, provide an independent audit of the adequacy of such system, and provide a report on these matters to the FCC and others in the call chain, unless alternative contractual arrangements have been made. We have indirectly paid, and intend to continue paying, payphone service providers as part of our prepaid calling card business. We have contracted with a clearinghouse to remit funds directly to payphone service providers for calls originating from payphones utilizing our prepaid calling cards. For all other types of traffic related to our wholesale Trading business, we believe that we are not responsible for payphone compensation, but rather that the carrier that precedes us bears that responsibility. In accordance therewith, for traffic related to our wholesale Trading business, we have in most cases sought to apportion such responsibility by contract.

We have also been questioned by regulators about our offerings. Under current standards and recent FCC decisions, the FCC and state regulatory authorities may not agree with our positions. If they do not, we could be penalized, become subject to regulation at the federal and state level for our wholesale Trading business, in addition to our Retail business, and could become subject to licensing and bonding requirements, federal and state fees and taxes, and other laws, all of which could materially affect our business.

We are also subject to federal and state laws and regulations regarding consumer protection, advertising, and disclosure regulations. These rules could substantially increase the cost of doing business domestically and in any particular state. Law enforcement authorities may utilize their powers under consumer protection laws against us in the event we do not meet legal requirements in a given jurisdiction which could either increase costs or prevent us from doing business there.

We are subject to other laws related to our business dealings that are not specifically related to telecommunications regulation. As an example, the Office of Foreign Asset Control of the U.S. Department of the Treasury, or OFAC, administers the United States' sanctions against certain countries. OFAC rules restrict many business transactions with such countries and, in some cases, require that licenses be obtained for such transactions. We may currently, or in the future, transmit telephone calls between the U.S. and countries subject to U.S. sanctions regulations and undertake other transactions related to those services. We have undertaken such activities via our network or through various reciprocal traffic exchange agreements to which we are a party. We have received licenses from OFAC to send traffic to some countries and, if necessary, will remain in contact with OFAC with regard to other transactions. Failure to obtain proper authority could expose us to legal and criminal liability.

### **Foreign government telecommunications regulation could also affect our costs.**

Our Retail and wholesale Trading services are offered in foreign jurisdictions. The regulation of VoIP differs from jurisdiction to jurisdiction. We cannot be certain that we or our partners and distributors are in compliance with all of the relevant regulations and laws in each of the foreign jurisdictions in which we operate at any given point in time. As a result, changes in regulation in foreign jurisdictions or failure to comply with applicable foreign laws and regulations can subject us to enforcement action and penalties that could negatively affect our business and ability to continue to provide services in these foreign jurisdictions. In addition, in numerous countries where we operate or plan to operate, we may be subject to many local laws and regulations that, among other things, may

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restrict or limit the ability of telecommunications companies to provide telecommunications services in competition with state-owned or state-sanctioned dominant carriers.

### **Other international governmental regulation and legal uncertainties and other laws could limit our ability to provide our services, make them more expensive, or subject us or our employees to legal or criminal liability.**

Many countries currently prohibit or limit competition in the provision of traditional voice telephony services. In some of those countries, licensed telephony carriers as well as government regulators and law enforcement authorities have questioned our legal authority and/or the legal authority of our service partners or affiliated entities and employees to offer our services. We may face similar questions in additional countries. Our failure to qualify as a properly licensed service provider, or to comply with other foreign laws and regulations, could materially adversely affect our business, financial condition and results of operations, including subjecting us or our employees to taxes and criminal or other penalties and/or by precluding us from, or limiting us in, enforcing contracts in such jurisdictions.

It is also possible that countries may apply to our activities laws relating to services provided over the Internet, including laws governing:

- sales and other taxes, including payroll-withholding applications;
- user privacy;
- pricing controls and termination costs;
- characteristics and quality of products and services;
- qualification to do business;
- consumer protection;
- cross-border commerce, including laws that would impose tariffs, duties and other import restrictions;
- copyright, trademark and patent infringement; and
- claims based on the nature and content of Internet materials, including defamation, negligence and the failure to meet necessary obligations.

If foreign governments or other bodies begin to impose related restrictions on our services or otherwise enforce criminal or other laws against us, our affiliates or our employees, such actions could have a material adverse effect on our operations.

The termination cost for the termination of calls to mobile networks in many countries are increasingly becoming subject to regulatory control. Recent decisions by the German, Belgium and Portuguese regulatory authorities to reduce the mobile termination rates, or MTRs, have been challenged by the affected mobile network operators, or MNOs, in the courts of such countries. Although we are not a party to these proceedings, under our contracts with these MNOs, a decision by a court to repeal the reduction of the MTR on a retroactive basis would permit the MNOs to retroactively increase the MTR charged to us for the termination of calls to their networks. Although we have taken steps to allow us to pass these potential cost increase on to our customers, there can be no assurance that we will be successful in doing so in all cases. We can not at this time assess the likelihood that the courts will retroactively repeal the reduction in the MTRs or the amount of any potential loss that we might suffer as a result.



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***Risks Related to Our Intellectual Property***

**If we are unable to protect our intellectual property, our competitive position would be adversely affected.**

We rely on patent, trademark and copyright law, trade secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our intellectual property. Unauthorized third parties may copy our services or reverse engineer or obtain and use information that we regard as proprietary. End-user license provisions protecting against unauthorized use, copying, transfer and disclosure of any licensed program may be unenforceable under the laws of certain jurisdictions and foreign countries. We have obtained one patent to-date and we may seek to obtain patents for certain processes or equipment in the future. We do not know if any of our pending patent applications will be issued with the scope of the claims we seek, if at all. In addition, the laws of some foreign countries do not protect proprietary rights to the same extent as do the laws of the United States. Our means of protecting our proprietary rights in the United States or abroad may not be adequate and third parties may infringe or misappropriate our copyrights, trademarks and similar proprietary rights. If we fail to protect our intellectual property and proprietary rights, our business, financial condition and results of operations would suffer.

**Our services might be found to infringe the intellectual property rights of others.**

We believe that we do not infringe upon the valid proprietary rights of any third party. Nonetheless, we have received claims that our products or brands, or those of our retail prepaid calling card distributors, infringe valid patents or trademarks. Such claims, even if resolved in our favor, could be substantial, and the litigation could divert management efforts. It is also possible that such claims might be asserted successfully against us in the future. Our ability to provide services depends on our freedom to operate. That is, we must ensure that we do not infringe upon the proprietary rights of others or have licensed all such rights. A party making an infringement claim could secure a substantial monetary award or obtain injunctive relief that could effectively block our ability to provide services in the United States or abroad. In addition, the assertion of infringement claims by others against our customers, including those providing consumer VoIP services, could adversely affect our business.

**We rely on a variety of technologies, primarily software, which is licensed from third parties or is freely available.**

Continued use of certain technology by us requires that we purchase new or additional licenses from third parties or, in some cases, avail ourselves of "shareware" or otherwise available open source code. We may not be able to obtain those third-party licenses needed for our business or the technology and software that we do have may not continue to be available to us on commercially reasonable terms or at all. The loss or inability to maintain or obtain upgrades to any such technology or software could result in delays or breakdowns in our ability to continue developing and providing our services or to enhance and upgrade our services.

***Risks Related to the Internet and Internet Telephony Industry***

**If the public Internet infrastructure is not adequately maintained, we may be unable to maintain the quality of our services and provide them in a timely and consistent manner.**

Our future success will depend upon the maintenance of the public Internet infrastructure, including a reliable network backbone with the necessary speed, data capacity and security for providing reliability and timely Internet access and services. To the extent that the Internet continues to experience increased numbers of users, frequency of use or bandwidth requirements, the Internet may become congested and be unable to support the demands placed on it and its performance or reliability may decline thereby impairing our ability to complete calls and provide other services using the



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Internet at consistently high quality. The Internet has experienced a variety of outages and other delays as a result of failures of portions of its infrastructure or otherwise. Future outages or delays could adversely affect our ability to complete calls and provide other services. Moreover, critical issues concerning the commercial use of the Internet, including security, cost, ease of use and access, intellectual property ownership and other legal liability issues, remain unresolved and could materially and adversely affect both the growth of Internet usage generally and our business in particular. Finally, important opportunities to increase traffic on The iBasis Network will not be realized if the underlying infrastructure of the Internet does not continue to be expanded to more locations worldwide.

### **Network security breaches could adversely affect our operations.**

We currently have practices, policies and procedures in place to ensure the integrity and security of our network. Nevertheless, from time to time we have experienced fraudulent activities whereby perpetrators have disguised themselves as our customers and transmitted traffic to us, or have disguised themselves as us and transmitted traffic to our communications service providers and other service providers for termination. While we have undertaken steps to thwart such fraud, including revamping our securities procedures and capabilities and alerting other members of the industry as well as law enforcement personnel, such actions may not be sufficient and financial exposure and reputational damage from fraudulent activities could materially adversely affect us.

### **Undetected defects in our technology could adversely affect our operations.**

Our technology is complex and is susceptible to errors, defects or performance problems, commonly called "bugs". Although we regularly test our software and systems extensively, we can not ensure that our testing will detect every potential bug. Any such bug could materially adversely affect our business.

### **Our ability to provide our services using the Internet may be adversely affected by computer vandalism.**

If the overall performance of the Internet is seriously downgraded by website attacks, failure of service attacks, or other acts of computer vandalism or virus infection, our ability to deliver our communication services over the Internet could be adversely impacted, which could cause us to have to increase the amount of traffic we have to carry over alternative networks, including the more costly public switched telephone network. In addition, traditional business interruption insurance may not cover losses we could incur because of any such disruption of the Internet. While some insurers are beginning to offer products purporting to cover these losses, we do not have any of this insurance at this time.

### ***Risks Related to the KPN Transaction***

#### **We may not be able to timely and successfully integrate KPN' international wholesale voice business with our operations, and thus we may fail to realize all of the anticipated benefits of the KPN Transaction.**

Integration of KPN' international wholesale voice business into our business is a complex, time consuming and costly process. While most of the work associated with this integration has been completed, remaining projects include the integration of back office systems used in billing, market analysis, routing, rating and financial and management reporting. Difficulties we may encounter include:

- operational interruptions or the loss of key employees, customers or suppliers;

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- the risks related to operating a significantly larger company with operations in geographic areas in which we have not previously operated; and
- risks related to consolidating our corporate and administrative functions.

We are also exposed to other risks that are commonly associated with similar transactions, such as unanticipated liabilities and costs, some of which may be material, and diversion of management's attention. As a result, the anticipated benefits of the KPN Transaction, including anticipated synergies, may not be fully realized and our business may be materially and adversely affected.

### **KPN owns a majority of the shares of our common stock, and we are a controlled company within the meaning of NASDAQ Marketplace Rules.**

Because KPN is deemed to beneficially own, in the aggregate, more than 50% of our common stock, we are a "controlled company" within the meaning of NASDAQ Marketplace Rule 4350(c)(5). As a result, the Company is exempt from NASDAQ rules that require listed companies to have (i) a majority of independent directors on the Board of Directors, (ii) the compensation of executive officers determined by a majority of independent directors or a compensation committee composed solely of independent directors, and (iii) a majority of the independent directors or a nominating committee composed solely of independent directors elect or recommend director nominees for selection by the Board of Directors. Furthermore, as part of the transaction, our by-laws were amended to provide KPN certain board representation rights and certain veto rights. As a result of these changes, and KPN's majority holdings, KPN has the ability to control the outcome of all matters submitted to our stockholders for approval. We cannot make assurances that the interests of KPN will be consistent with the interests of other holders of our common stock, or that KPN will vote its shares of common stock, or exercise its veto rights, in a manner that benefits other holders of our common stock.

Finally, KPN's ownership of 56% of the shares of our issued and outstanding shares of common stock as of December 31, 2008 could discourage the acquisition of our common stock by potential investors and could have an anti-takeover effect, possibly depressing the trading price of our common stock.

### **KPN may sell all or a substantial portion of its shares at any time in the future, which could cause the market price of our common stock to decline.**

We have not entered into any lock-up agreement with KPN. As a result, the sale, or the possibility of a sale, by KPN of all or a substantial number of its shares in the public market could cause the market price of our common stock to decline. The sale of a substantial number of shares or the possibility of such a sale also could make it more difficult for us to sell our common stock or other equity securities in the future at a time and at a price that we deem appropriate.

### **Provisions of our governing documents and Delaware law could also discourage acquisition proposals or delay a change in control.**

Our certificate of incorporation and our by-laws contain anti-takeover provisions, including those listed below, that could make it difficult for a third party to acquire control of our company, even if that change in control would be beneficial to stockholders:

- our Board of Directors has the authority to issue common stock and preferred stock, and to determine the price, rights and preferences of any new series of preferred stock, without stockholder approval;
- our Board of Directors is divided into three classes, each serving three-year terms;

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- a supermajority of votes of our stockholders is required to amend key provisions of our certificate of incorporation and by-laws;
- our by-laws contain provisions limiting who can call special meetings of stockholders;
- our stockholders may not take action by written consent; and
- our stockholders must provide specified advance notice to nominate directors or submit stockholder proposals.

In addition, provisions of Delaware law and our stock incentive plans may discourage, delay or prevent a change of control of our company or an unsolicited acquisition proposal.

### **Our business could be adversely affected by changes in our commercial dealings with Royal KPN and its subsidiaries.**

Pursuant to a framework services agreement negotiated as part of the consideration for the KPN Transaction (the "Framework Services Agreement"), we are the exclusive provider of international direct dialing, ISDN and Immarsat services for all international telephone and fax traffic originating from or carried over the fixed networks of Royal KPN, KPN and all their affiliates and subsidiaries (the "Royal KPN Group"). We carry this traffic at the expected cost of providing services plus a margin as set forth in the Framework Services Agreement at declining rates through the year 2010. Thereafter, margins will be negotiated each year. The Framework Services Agreement has a ten year term; however, there can be no assurance after 2010 that we will be able to negotiate margins on this traffic on terms and conditions that are favorable to us.

We were also appointed as a preferred supplier of mobile services for the Royal KPN Group pursuant to the Framework Services Agreement. While we are confident that we will continue to provide mobiles services for the Royal KPN Group, there can be no assurance that this will occur on terms and conditions that are favorable to us.

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***SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS***

This Annual Report on Form 10-K and, in particular, the description of our Business set forth in Item 1, the Risk Factors set forth in this Item 1A and our Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Item 7 contain or incorporate a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding:

- our expectations regarding our ability to expand our market share in our wholesale Trading business;
- our expectations regarding the number of customers that will use our wholesale Trading and Retail services;
- our expectations regarding the future market demand for our wholesale Trading and Retail services;
- the size of our market;
- our expectations regarding the timing and benefit of synergies we may realize from the KPN transaction;
- our expectations regarding our growth being favorably impacted by consolidation in our industry;
- our expectations regarding benefits we may realize when we have converted our customers from our TDM network our all-IP network;
- our business strategy;
- the focus of our marketing efforts;
- the establishment, development and maintenance of relationships with strategic partners;
- our estimates regarding obligations associated with our leased facilities;
- our expectations regarding the outcome of the legal proceedings that we are currently a party to, including our defense strategies, the results of negotiations and settlements in such legal proceedings and our estimates regarding the amount of fees and losses to be paid in connection with such legal proceedings;
- our expectations that the VoIP market offers significant growth potential for us;
- the exposure for higher access costs related to our Retail business;
- uncertainty related to current economic conditions and any resulting decreased demand for our products;
- potential for future impairment of our long-lived assets; and
- our liquidity.

Any or all of our forward-looking statements in this Annual Report on Form 10-K may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Annual Report on Form 10-K will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially.

We also provide a cautionary discussion of risks and uncertainties under "Risk Factors" in Item 1A. These are factors that we think could cause our actual results to differ materially from expected results. Other factors besides those listed there could also adversely affect us.



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Without limiting the foregoing, the words "believes," "anticipates," "plans," "expects" and similar expressions are intended to identify forward-looking statements. There are a number of factors that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control, including the Risk Factors set forth under Item 1A. In addition, the forward-looking statements contained herein represent our estimate only as of the date of this filing and should not be relied upon as representing our estimate as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

### **Item 1B. *Unresolved Staff Comments***

Not applicable.

### **Item 2. *Properties***

The following is a summary of our primary facilities:

<u>Location</u>	<u>Square Footage</u>	<u>Expiration of Lease</u>	<u>Facility Use</u>
Burlington, MA	59,265	April 2010	Headquarters and global network operations center
The Hague, The Netherlands	16,250	Rented from KPN	Office
New York, NY	4,372	Various, 2009-2018	Internet central office
Los Angeles, CA	3,156	April 2009	Internet central office

Our office space in The Hague is rented from KPN under a service level agreement. In addition to the facilities listed above, we lease office space, or space to house network equipment, in various locations around the world, including London, Paris, Frankfurt, Sydney, Buenos Aires, Hong Kong, Beijing and Tokyo. We believe that our existing facilities are adequate for our current needs and that suitable additional or alternative space will be available in the future on commercially reasonable terms.

### **Item 3. *Legal Proceedings***

In addition to litigation that we have initiated or responded to in the ordinary course of business, we are currently party to the following potentially material legal proceedings:

#### *Class Action Pursuant to 1999 Initial Public Offering*

In 2001, we were served with several class action complaints that were filed in the United States District Court for the Southern District of New York against us and several of our officers, directors, and former officers and directors, as well as against the investment banking firms that underwrote our November 10, 1999 initial public offering of common stock and our March 9, 2000 secondary offering of common stock. The complaints were filed on behalf of a class of persons who purchased our common stock between November 10, 1999 and December 6, 2000.

The complaints are similar to each other and to hundreds of other complaints filed against other issuers and their underwriters, and allege violations of the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), primarily based on the assertion that there was undisclosed compensation received by our underwriters in connection with our public offerings and that there were understandings with customers to make purchases in the aftermarket.

In September 2001, the complaints were consolidated and allege that our prospectuses failed to disclose these arrangements. The consolidated complaint seeks an unspecified amount of monetary

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damages and other relief. In October 2002, the individual defendants were dismissed from the litigation by stipulation and without prejudice and subject to an agreement to toll the running of time-based defenses. In February 2003, the district court denied our motion to dismiss.

In June 2004, we and the individual defendants, as well as many other issuers named as defendants in the class action proceeding, entered into an agreement-in-principle to settle this matter, and this settlement was presented to the court. The district court granted a preliminary approval of the settlement in February 2005, subject to certain modifications to the proposed bar order, to which plaintiffs and issuers agreed. In August 2005, the district court issued a preliminary order further approving the modifications to the settlement, certifying the settlement classes and scheduled a fairness hearing, after notice to the class. Plaintiffs have continued to pursue their claims against the underwriters. The district court established a procedure whereby six "focus" cases are being pursued initially and has certified a class of purchasers in those cases. The underwriters appealed the certification order in each of the six cases and in December 2006, the United States Court of Appeals for the Second Circuit reversed the certification orders. Motions to dismiss amended complaints filed in the six focus cases have been denied.

We anticipate additional settlement negotiations will occur, but there can be no assurance that those negotiations will result in a revised settlement. We believe that if this matter is not settled, we have meritorious defenses which we intend to vigorously assert.

We cannot estimate potential losses, if any, from these matters or whether, in light of our insurance coverage, any loss would be material to our financial condition, results of operations or cash flows. As such, no amounts have been accrued as of December 31, 2008.

### *SEC Option Investigation*

We announced on October 20, 2006, that we were contacted by the SEC as part of an informal inquiry and we further disclosed on March 29, 2007, on our Current Report on Form 8-K, that the SEC had notified us that we would be receiving a formal order of investigation relating to our stock option practices. On April 13, 2007, we received the formal order of investigation. The SEC investigation sought documents and information from us relating to the grant of our options from 1999 through 2006. The SEC has taken testimony from individuals including certain of our current and former officers and directors. We have cooperated fully with the SEC investigation and we are in communication with the SEC staff regarding the outcome of the investigation. There is no assurance that we will be able to resolve the SEC investigation on acceptable terms without the institution of enforcement proceedings by the SEC against us or one or more of our senior executive officers or that other inquiries will not be commenced by other U.S. federal, state or other regulatory agencies. An SEC enforcement proceeding could seek an injunction against future violations of the securities laws, a civil penalty and, as to individual executives, disgorgement and a bar order against serving as an officer or director of a publicly traded company. A bar order as to any of our senior executive officers would deprive us of any such executive's services and could have a material adverse affect on our business.

We cannot estimate the amount of losses, if any, from the SEC investigation, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amounts have been accrued as of December 31, 2008.

### *Sub-Distributor Action*

On September 20, 2007, J & J Communications ("J & J"), a sub-distributor of calling cards distributed through iBasis distributor Abdul Communications ("Abdul"), amended a complaint filed in the United States District Court for the District of Maryland against Abdul, to add iBasis and PCI, a wholesale calling-card provider ("PCI"), as defendants in the matter. The complaint asserts that J & J has lost and continues to lose money because iBasis and PCI deactivated calling cards for which J & J

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allegedly paid. J & J is seeking in excess of \$1.0 million dollars, plus punitive damages, attorneys fees and litigation costs based on a variety of claims against Abdul, iBasis, and PCI, predicated on contractual theories, various torts, conspiracy and an alleged violation of § 201 of the Telecommunications Act. With respect to iBasis, J & J alleges both direct liability and vicarious liability, for its alleged status as principal in an alleged agency relationship with Abdul. iBasis responded to the amended complaint through an answer and motion to dismiss on February 8, 2008. On June 2, 2008, the Court dismissed the conspiracy and Telecommunications Act claims. Discovery is proceeding as to the remaining claims.

We cannot estimate the amount of losses, if any, from this matter, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amount has been accrued as of December 31, 2008.

### *Bankruptcy Preference Claim*

On April 24, 2001 (the "Petition Date"), World Access, Inc. ("World Access"), WorldxChange Communications, Inc. ("WorldxChange"), and Facicom International, LLC ("Facicom"), together with other related debtors (collectively, the "Debtors"), filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Northern District of Illinois (Eastern Division). The Debtors' cases are jointly administered but have not been substantively consolidated. Prior to the Petition Date, we and the Debtors engaged in a reciprocal business relationship. On or about April 21, 2003 the Debtors initiated a large number of avoidance actions, including an adversary proceeding in which the Debtors asserted claims against us for allegedly preferential transfers and nonpayment of overdue amounts owed by iBasis to the Debtors totaling approximately \$2.1 million. We have asserted defenses to the claims, invoked statutory defenses and filed proofs of claim for approximately \$0.5 million to which the trustee for the Debtors has objected. We expect to engage in a mediation to attempt to resolve these claims during the first quarter of 2009 and have determined that it is probable that we will incur a liability of approximately \$0.5 million and, accordingly, we have accrued that amount as of December 31, 2008.

### *Consumer Class Action*

We were named in a putative consumer class action complaint, filed in the United States District Court for the District of New Jersey. We were served on May 27, 2008. The putative class action plaintiff, Orlando Ramirez, asserted violations of consumer protection statutes in New Jersey and other states on behalf of an asserted nationwide class of purchasers due to an alleged failure to adequately disclose the actual calling time available on iBasis' prepaid calling cards. We filed a motion to change venue to the Eastern District of New York where named plaintiff resides and purchased the card. Plaintiffs were granted a voluntary dismissal, without prejudice, on July 9, 2008. On December 19, 2008, a substantially similar complaint was filed against us on behalf of Mr. Ramirez in the United States District Court for the Eastern District of New York. As of March 6, 2009, we have not been served with this complaint. We believe that we have substantial defenses to the claims alleged in the complaint and, if served, we intend to vigorously defend against the claims asserted. We cannot estimate the amount of losses, if any, from this matter, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amount has been accrued as of December 31, 2008.



[Table of Contents](#)*Other Matters*

We are also subject to suits for collection, related commercial disputes, claims by former employees, claims related to certain taxes, claims from carriers and foreign service partners over reconciliation of payments for circuits, Internet bandwidth and/or access to the public switched telephone network, and claims from estates of bankrupt companies alleging that we received preferential payments from such companies prior to their bankruptcy filings. We cannot estimate the amount of losses, if any, from these matters, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amount has been accrued as of December 31, 2008.

**Item 4. *Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2008.

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## PART II

### Item 5. *Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

#### *Market Information*

Our common stock is traded on The NASDAQ Global Market under the symbol "IBAS." The following table sets forth the high and low sales prices of our common stock, as reported by The NASDAQ Global Market for the periods indicated.

	<u>High</u>	<u>Low</u>
<b>Fiscal 2008:</b>		
Fourth Quarter	\$ 3.38	\$1.20
Third Quarter	\$ 4.32	\$3.06
Second Quarter	\$ 4.26	\$3.05
First Quarter	\$ 5.70	\$3.54
<b>Fiscal 2007:</b>		
Fourth Quarter	\$10.65	\$4.90
Third Quarter	\$10.75	\$8.67
Second Quarter	\$10.99	\$9.88
First Quarter	\$10.99	\$8.54

#### *Stockholders*

As of February 28, 2009, we had 185 stockholders of record. This does not reflect persons or entities that hold their shares of common stock in nominee or "street" name through various brokerage firms.

#### *Dividends*

Following the closing of the KPN Transaction, we paid to our shareholders of record as of September 28, 2007, the business day immediately preceding the closing, a dividend in an aggregate amount of \$113 million, or \$3.28 per share of common stock. The funds used to pay the dividend came from cash on hand, proceeds of \$55 million received from KPN in connection with the transaction, and bank borrowings. Also, under the terms of outstanding warrants for our common stock, upon exercise of such warrants after the closing of the KPN Transaction, the holders of the warrants are entitled to receive payment of an amount in cash equal to the amount such holder would have received in connection with the dividend payment if such warrants had been exercised immediately prior to the closing of the KPN Transaction, in addition to the number of shares of common stock issuable upon such exercise. Cumulatively through December 31, 2008, we have paid holders of warrants a total \$0.8 million in dividends upon the exercise of their warrants. As of December 31, 2008, we have unexercised warrants representing 432,000 shares, at exercise prices ranging from \$6.30 to \$9.00 per share, and have \$1.4 million accrued for dividends to be paid upon the potential future exercise of these warrants.

Other than as disclosed above, we have no current intention of declaring or paying cash dividends on our common stock in the future.

#### *Stock Repurchase Program*

In April 2008, we announced that our board of directors had approved a stock repurchase program, authorizing us to purchase up to \$15.0 million of our common stock over the next six months. Between May and August 2008, we completed this program by purchasing 3.9 million shares of our

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common stock for a total cost of \$15.0 million, as set forth in the table below. The repurchases were made in the open market and in privately negotiated purchases. The timing and amount of the shares we purchased were determined by our management based on our evaluation of market conditions and other factors. No shares were purchased from KPN as part of this program.

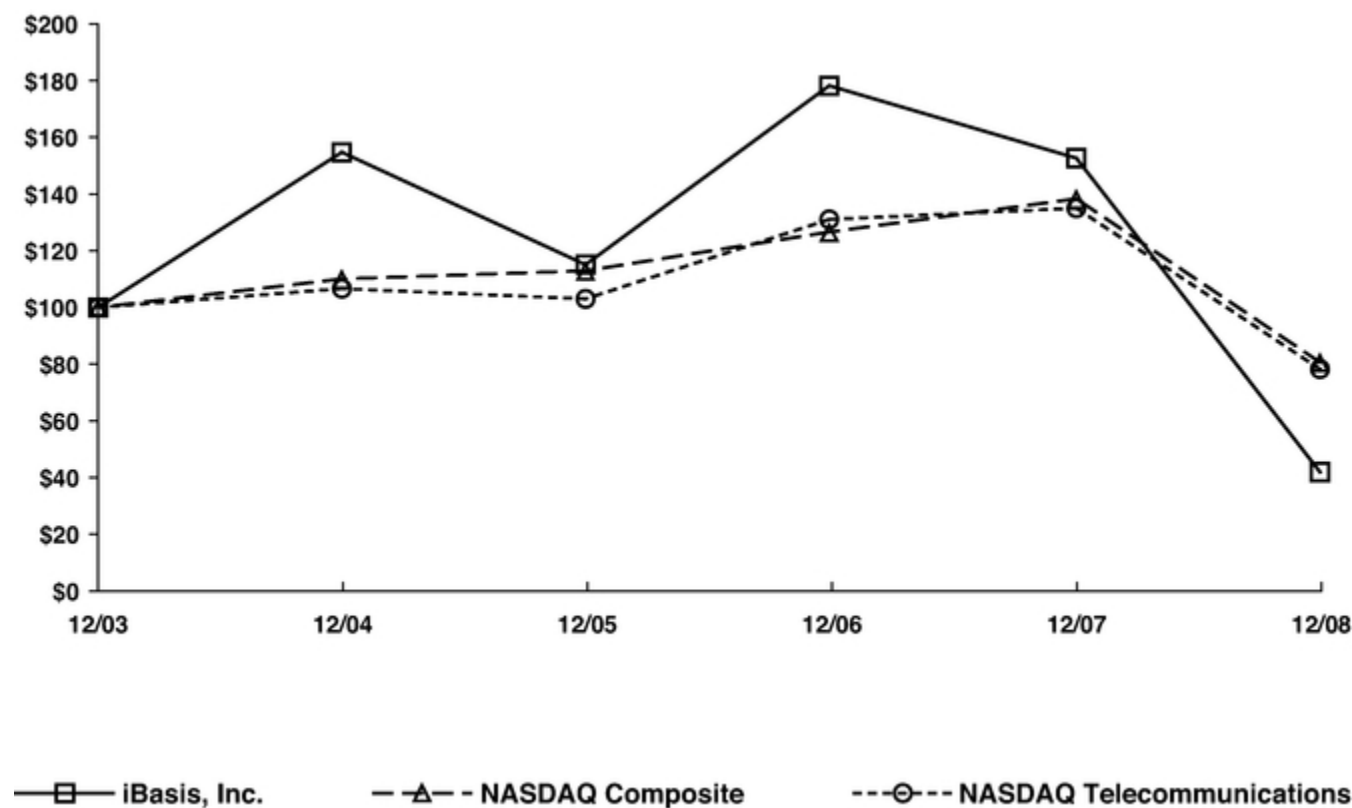
<u>Period</u>	<u>Total Shares Purchased</u>	<u>Average Price Paid per Share</u>
May 1, 2008—May 31, 2008	886,300	\$ 3.33
June 1, 2008—June 30, 2008	536,100	\$ 3.58
July 1, 2008—July 31, 2008	331,400	\$ 3.71
August 1, 2008—August 31, 2008	2,153,140	\$ 4.14
Total	<u>3,906,940</u>	<u>\$ 3.84</u>

*Securities Authorized for Issuance Under Equity Compensation Plans*

The information required by this item is included under the caption "Equity Compensation Plan Information" in the 2009 Proxy Statement and is incorporated herein by reference.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***

Among iBasis, Inc., The NASDAQ Composite Index  
And The NASDAQ Telecommunications Index



\*\$100 invested on 12/31/03 in stock or index, including reinvestment of dividends.  
Fiscal year ending December 31.



[Table of Contents](#)**Item 6. *Selected Financial Data***

The following selected consolidated financial data should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. Although iBasis acquired all of the outstanding capital stock of KPN GCS on October 1, 2007, for accounting and financial statement purposes, the KPN Transaction has been treated as a reverse acquisition of iBasis by KPN GCS under the purchase method of accounting and the financial results of KPN GCS have become the historical financial results of the combined company and replace the historical financial results of iBasis as a stand-alone company. As a result, revenue and operating expenses for the years ended December 31, 2008 and 2007 increased substantially, as more fully discussed in Item 7. The consolidated statement of operations for the year ended December 31, 2007, reflects the results of KPN GCS only for the first nine months of 2007 and the results of the combined company, following the closing of the KPN Transaction on October 1, 2007, for the fourth quarter of 2007. This selected financial data has been derived from our audited consolidated financial statements. The consolidated statement of operations data for each of the three years ended December 31, 2006, 2005, and 2004 and the balance sheet data at December 31, 2006 and 2005 are derived from the audited consolidated financial statements of KPN GCS. The balance sheet data at December 31, 2004 has been derived from KPN GCS' unaudited consolidated financial statements.

From inception until October 1, 2007, KPN GCS operated as integrated part of KPN and within the Royal KPN infrastructure. As a consequence, KPN GCS has not operated as a stand-alone business. The KPN GCS combined financial statements were derived from the accounting records of KPN using the historical bases of assets and liabilities. However, these historical financial statements may not necessarily be representative of amounts that would have been reflected in such combined financial statements had KPN GCS operated independently of KPN. For example, KPN GCS benefited from certain related party revenue and purchase agreements with KPN that included sale prices per minute and costs per minute that were not necessarily representative of the amounts that would have been reflected in the financial statements had KPN GCS operated independently of KPN.

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	Year Ended December 31,				
	2008	2007	2006	2005	2004
	(In thousands)				
<b>Statement of Operations Data:</b>					
Net revenue from external parties	\$1,097,515	\$741,293	\$605,031	\$540,574	\$498,357
Net revenue from related parties	226,070	197,265	209,158	249,502	216,559
Total revenue	1,323,585	938,558	814,189	790,076	714,916
Costs and operating expenses:					
Data communications and telecommunications costs— external parties	1,081,460	733,160	573,966	533,055	475,814
Data communications and telecommunications costs— related parties	105,840	114,242	134,347	138,584	161,347
Engineering and network operations	23,320	13,222	8,895	11,438	—
Selling, general and administrative	74,849	38,368	29,812	34,468	18,569
Merger related expenses	—	2,019	—	—	—
Depreciation and amortization	31,998	12,743	5,693	11,415	13,665
Impairment of goodwill	214,651	—	—	—	—
Total costs and operating expenses	1,532,118	913,754	752,713	728,960	669,395
Income (loss) from operations	(208,533)	24,804	61,476	61,116	45,521
Interest income (expense), net	(982)	949	237	(107)	(101)
Foreign exchange gain (loss)	3,089	(1,101)	(1,339)	(1,545)	(4,291)
Other income	1,779	—	—	—	—
Income (loss) before income taxes	(204,647)	24,652	60,374	59,464	41,129
Income tax expense	26,342	8,529	17,884	18,848	13,546
Net income (loss)	<u>\$ (230,989)</u>	<u>\$ 16,123</u>	<u>\$ 42,490</u>	<u>\$ 40,616</u>	<u>\$ 27,583</u>
Basic and diluted net income (loss) per share	\$ (3.15)	\$ 0.33	\$ 1.06	\$ 1.01	\$ 0.69
Weighted average shares:					
Basic	73,260	48,778	40,121	40,121	40,121
Diluted	73,260	49,186	40,121	40,121	40,121
<b>Balance Sheet Data:</b>					
Cash, cash equivalents and short-term marketable securities	\$ 56,912	\$ 65,735	\$ 22,411	\$ 20,630	\$ 29,903
Working capital (deficit)	(21,444)	(20,756)	12,967	(3,633)	3,860
Total assets	441,327	659,873	233,269	223,999	285,256
Long-term debt, net of current portion	27,380	25,000	—	—	1,087
Stockholders' equity	88,518	334,490	23,978	7,709	20,626

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**Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

**Company Overview**

We are a leading wholesale carrier of international long distance telephone calls and a provider of retail prepaid calling services and enhanced services for mobile operators.

Our operations consist of our wholesale trading business ("Trading"), in which we connect buyers and sellers of international telecommunications services, and our retail services business ("Retail"). Our Trading business also includes Outsourcing revenue which we generate as the exclusive provider of wholesale international voice services for specific carrier customers.

In the Trading business we receive voice traffic from buyers—originating telecommunications carriers who are interconnected to our network via Voice over Internet Protocol ("VoIP") or traditional time division multiplexing ("TDM") connections, and we route that traffic over our network to sellers—local service providers and telecommunications carriers in the destination countries with whom we have established agreements to manage the completion or termination of calls. We offer our Trading service on a wholesale basis to carriers, mobile operators, consumer VoIP companies, telephony resellers and other service providers worldwide. Our Outsourcing revenue currently consists of international voice traffic we terminate for Royal KPN and its affiliates (KPN Mobile, E-Plus and Base) and for TDC, the leading telecommunications carrier in Denmark. We seek to expand our market share in our Trading business by expanding our customer base and by introducing cost-effective international voice solutions for our customers, including complete outsourcing of international operations.

As a result of the combination with KPN GCS in October 2007 (described below), more than half of our traffic utilizes our VoIP network, while the balance is carried over our TDM network. The continued migration of the TDM traffic to our lower cost VoIP network is expected to be a significant source of synergies from the KPN transaction over the next several years.

Our Retail business consists of retail prepaid calling cards, which are marketed through distributors primarily to ethnic communities within major metropolitan markets in the United States, and Pingo®, a prepaid calling service that we offer and sell directly to consumers via an eCommerce model. Both can be private-labeled for other service providers. The prepaid calling card business and Pingo leverage our existing international network and have the potential to deliver higher margins than are typically achieved in the wholesale Trading business. In addition, the retail prepaid calling card business typically has a faster cash collection cycle than the wholesale Trading business. In 2007 we launched PingoBusiness, enhancements that enable businesses to manage multiple Pingo accounts through a single administrative account.

We use proprietary, patented and patent-pending technology in our global VoIP network to automate the selection of routes and termination partners based on a variety of performance, quality, and business metrics. We have call termination agreements with local service providers in more than 100 countries in North America, Europe, Asia, the Middle East, Latin America, Africa and Australia.

**KPN Transaction**

On October 1, 2007, iBasis, Inc. and KPN completed transactions ("KPN Transaction") pursuant to which iBasis issued 40,121,074 shares of its common stock to KPN and acquired the outstanding shares of two subsidiaries of KPN ("KPN GCS"), which encompassed KPN's international wholesale voice business. The Company also received \$55 million in cash from KPN, subject to post-closing adjustments based on the working capital and debt of iBasis and KPN GCS. Immediately after issuance on October 1, 2007, the shares of iBasis common stock issued to KPN represented 51% of the issued and outstanding shares of iBasis common stock on a fully-diluted basis (which includes all of the issued and outstanding common stock and the common stock underlying outstanding "in-the-money" stock

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options, as adjusted, and warrants to purchase common stock). As of December 31, 2008, the 40,121,074 shares owned by KPN represent 56% of the issued and outstanding common stock of iBasis and 56% on a fully-diluted basis, as defined above.

On October 8, 2007, iBasis paid a dividend in the amount of \$113 million at a rate of \$3.28 per share to each of its shareholders on the record date of September 28, 2007, the trading date immediately prior to the closing date of the KPN Transaction. In addition, holders of outstanding warrants to purchase our common stock will be entitled to receive a cash payment upon the future exercise of these warrants in an amount equal to the dividend amount that would have been payable if the warrants had been exercised immediately prior to the record date of the dividend. Cumulatively through December 31, 2008, we have paid holders of warrants a total \$0.8 million in dividends upon the exercise of their warrants. As of December 31, 2008, we have unexercised warrants representing 432,000 shares, at exercise prices ranging from \$6.30 to \$9.00 per share, and have \$1.4 million accrued for dividends to be paid upon the potential future exercise of these warrants. In connection with the payment of the dividend to shareholders, we also increased the number of shares subject to unexercised stock options and decreased the exercise price of these stock option grants to preserve their value.

The officers of iBasis immediately prior to the closing of the KPN Transaction have continued to serve as the officers of the combined company and one executive of KPN GCS, Mr. Edwin Van Ierland, was appointed as the Company's Senior Vice President Worldwide Sales. Upon closing of the KPN Transaction, Messrs. Charles Skibo and David Lee, two independent members of iBasis' board of directors, resigned as members of the board of directors and the board of directors of iBasis appointed Messrs. Eelco Blok and Joost Farwerck, two executives of Royal KPN N.V., as directors to fill the vacancies created by the resignations of Messrs. Skibo and Lee.

Although iBasis acquired all of the outstanding capital stock of KPN GCS, after the closing of the transaction, KPN holds a majority of the outstanding common stock of iBasis and KPN's designees are expected to represent, at a future date, a majority of the Company's board of directors. Accordingly, for accounting and financial statement purposes, the KPN Transaction has been treated as a reverse acquisition of iBasis by KPN GCS under the purchase method of accounting and the financial results of KPN GCS have become the historical financial results of the combined company and replace the historical financial results of iBasis as a stand-alone company. Thus, the financial results reported for the full year 2007 include the results of KPN GCS alone for the first nine months of 2007 and the financial results of the combined company for the fourth quarter of 2007 only.

The presentation of the Statement of Stockholders' Equity reflects the historical stockholders' equity of KPN GCS through September 30, 2007. The effect of the issuance of shares of iBasis common stock to KPN and the inclusion of iBasis' stockholders' equity as a result of the closing of the KPN Transaction on October 1, 2007 are reflected in the year ended December 31, 2007.

Prior to October 1, 2007, KPN GCS operated as an integrated part of KPN since inception and the historical financial statements of KPN GCS have been derived from the accounting records of KPN using the historical bases of assets and liabilities. Because KPN GCS did not operate as a stand-alone business the historical financial statements may not necessarily be representative of amounts that would have been reflected in the financial statements presented had KPN GCS operated independently of KPN.

KPN GCS benefited from certain related party revenue and purchase agreements with KPN that included sales prices per minute and costs per minute. KPN GCS also relied on KPN for a substantial part of its operational and administrative support, for which it was allocated costs primarily consisting of selling, general and administrative expenses, such as costs for centralized research, legal, human resources, payroll, accounting, employee benefits, real estate, insurance, information technology, telecommunications, treasury and other corporate and infrastructure costs. In anticipation of the closing of the transaction with iBasis, KPN GCS entered into a Framework Services Agreement with KPN in



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2006, which replaced the related party revenue and purchase agreements and operational and administrative support arrangements described above.

***Purchase Accounting and Goodwill Impairment***

KPN GCS has been designated as the accounting acquirer because immediately following the completion of the transaction, the former shareholder of KPN GCS, KPN, held 51% of the common stock of the combined company on a fully-diluted basis and KPN's designees are expected to represent, at a future date, a majority of the combined company's board of directors. As a result, the transaction has been accounted for as a reverse acquisition under the purchase method of accounting. Under this accounting, KPN GCS is considered the acquiring entity and iBasis is considered the acquired entity for financial reporting purposes.

Under the purchase method of accounting, the purchase price was allocated to the tangible and identifiable intangible assets and liabilities of iBasis on the basis of their fair values on October 1, 2007, the closing date of the transaction. As KPN GCS was not a publicly traded entity, the purchase price for this transaction was based, in part, on the fair market value of iBasis' common stock. The market price used to value iBasis' shares of \$10.75 was the closing price of the stock on September 28, 2007, the business day immediately prior to the closing of the KPN Transaction.

The total purchase price for this transaction consisted of the following:

	<u>(In thousands)</u>
iBasis outstanding shares on October 1, 2007 of 34,451 at \$10.75 per share	\$ 370,353
Fair value of outstanding vested and unvested stock options, less unearned compensation	13,425
Fair value of outstanding warrants to purchase common shares	4,624
Direct acquisition costs	2,453
Dividend to iBasis shareholders paid from existing iBasis cash and short-term marketable securities	(58,000)
Accrued dividend payable for outstanding warrants to purchase common shares	(2,468)
Amount payable to KPN for iBasis working capital adjustment	(11,577)
Accrued severance	(135)
Total purchase price	<u>\$ 318,675</u>

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The allocation of the purchase to the fair values of iBasis' assets and liabilities on October 1, 2007, which resulted in the recording of \$248.8 million in goodwill, was as follows:

	<u>(In thousands)</u>
Current assets	\$ 128,875
Property and equipment	23,258
Other assets	520
Trade names and trademarks	21,800
Customer relationships	34,200
Termination partner relationships	8,400
Technology	33,300
Total assets	<u>250,353</u>
Deferred revenue	11,331
Dividend payable	60,468
Other current liabilities	103,469
Deferred tax liabilities, long term	3,556
Other non-current liabilities	1,649
Total liabilities	<u>180,473</u>
Net assets	69,880
Goodwill	248,795
Total purchase price	<u><u>\$ 318,675</u></u>

The total \$248.8 million of goodwill was assigned to the Company's wholesale Trading reporting unit. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," this goodwill has not been amortized. In the fourth quarter of 2008, the Company determined that the carrying value of goodwill was impaired. As a result, the Company recorded a charge for the impairment of goodwill in the amount of \$214.7 million. As a result of this impairment charge and a further reduction to the carrying value of goodwill of \$16.8 million for the utilization of previously reserved pre acquisition net operating losses, the carrying value of goodwill has been reduced to \$17.3 million as of December 31, 2008. See further discussion of the goodwill impairment charge recorded in 2008 in the Results of Operations section of the Management's Discussion and Analysis of Financial Condition and in Note 8 to the Consolidated Financial Statements.

### ***Working Capital and Debt Adjustments***

In accordance with the Share Purchase Agreement for the KPN Transaction, a post-closing adjustment was required if (i) iBasis' working capital was lower than or exceeded \$37,100,000; (ii) iBasis' debt exceeded or was lower than \$2,900,000; (iii) the combined working capital of KPN GCS was lower than or exceeded (\$6,100,000); and/or (iv) the combined debt of KPN GCS exceeded \$0, as of the date of the closing of the KPN Transaction. Based on iBasis' balance sheet position on the date of the closing of the KPN Transaction, working capital was \$13,353,000 less than the specified level of \$37,100,000, and debt was \$1,776,000 less than the specified level of \$2,900,000. As a result, a payment of \$11,577,000 was due to KPN from iBasis. Based on KPN GCS's balance sheet position on the date of the closing of the KPN Transaction, working capital exceeded the specified level of (\$6,100,000) by \$3,945,000 and debt was at the specified level of \$0. As a result, payment of \$3,945,000 was due to KPN from iBasis.

In 2008, KPN forgave \$1.3 million in expenses incurred by KPN GCS since the closing of the KPN Transaction. As a result, the amount due to KPN has been reduced by this amount and was recorded as a contribution to equity. These expenses have been recorded in our results of operations. The total

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amount of \$14.7 million due to KPN was scheduled to be paid by iBasis in three successive quarterly installments through the third quarter of 2008, with interest at the rate of 6% per annum. In May 2008, we made the first payment of \$5.2 million, including interest, to KPN. In September 2008, we revised the terms of the remaining balance of \$10.3 million due to KPN to extend the payment date on the second installment payment to March 2009 and the final installment to June 2009. In addition, the interest rate was increased to 7% on the principal amount due, effective October 1, 2008, and we paid additional interest of \$60,000 relating to the extension of the second installment that was due June 30, 2008.

As of December 31, 2008 and 2007, unpaid principal and accrued interest due KPN was \$10.5 million and \$15.5 million, respectively.

### ***TDC Transaction***

On April 1, 2008, we acquired certain assets from TDC, the leading telecommunications carrier in Denmark, as well as certain assets, contracts and four employees of TDC's subsidiary in the U.S., TDC Carrier Services U.S., for approximately \$11 million in cash ("TDC Transaction"). Pursuant to the TDC Transaction, we became the exclusive provider of international voice services for TDC under a five-year strategic outsourcing arrangement, and TDC will be a preferred partner for terminating traffic sent by us into the Nordic region, consisting of Denmark, Finland, Iceland, Norway and Sweden.

Approximately 130 non-Nordic international wholesale voice customers, as well as all of TDC's interconnection and bilateral agreements for inbound and outbound international phone calls have been transferred to us. TDC will retain its Nordic customer base and its pan-Nordic reach.

In connection with the closing of the TDC transaction, we recorded \$10.1 million of intangible assets, primarily wholesale customer relationships. The wholesale customer relationships are being amortized over a 5 to 10 year period using the economic consumption method to reflect the diminishing cash flows from these relationships in the future.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements. The preparation of these financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires us to (i) make judgments, assumptions and estimates that affect the reported amounts of assets, liabilities, revenue and expenses; and (ii) disclose contingent assets and liabilities. A critical accounting estimate is an assumption that could have a material effect on our consolidated financial statements if another, also reasonable, amount were used or a change in the estimates is reasonably likely from period to period. We base our accounting estimates on historical experience and other factors that we consider reasonable under the circumstances. However, actual results may differ from these estimates. To the extent there are material differences between our estimates and the actual results, our future financial condition and results of operations will be affected. The following is a summary of our critical accounting policies and estimates.

**Revenue Recognition.** For our Trading business, revenue is derived from the sale of minutes of calling time. We recognize revenue in the period the service is provided, net of estimates for incentive rebates, customer disputes and other allowances. These estimates are based upon contracted terms, historical experience and information currently available to management with respect to business and economic trends. Revisions to these estimates are recorded in the period in which the facts that give rise to the revision become known. In cases where we have to estimate the monthly revenues related to traffic terminated in that month, we record a receivable that is based upon internal traffic reporting which will then be billed and collected in the subsequent months. For our Retail business, revenue is

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deferred upon activation of the calling cards, or purchase of our web-based calling services, and is only recognized as the prepaid balances are reduced based upon minute usage and service charges.

*Allowance for Doubtful Accounts.* We perform ongoing credit evaluations of our customers and adjust credit limits based upon their payment history and current credit worthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and record a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. We believe that the allowance for doubtful accounts is adequate to cover estimated losses in customer accounts receivable balances under current conditions. However, changes in the allowance for doubtful accounts may be necessary in the event that the financial condition of our customers improves or deteriorates. In addition, changes may be necessary if we adjust credit limits for new customers or change our collection practices. Either of these situations may result in write-off patterns that differ from our experience. We have been able to mitigate our credit risk, in part, by using reciprocal arrangements with customers, who are also our suppliers, to offset our outstanding receivables.

*Intangible Assets.* Our intangible assets consist of goodwill, which has an indefinite life and is not being amortized, and identifiable intangible assets, consisting of trade name and trade marks, customer relationships, termination partner relationships and technology. The estimated useful life of trade name and trademarks is 15 years and is being amortized on a straight-line basis. The estimated useful life of customer relationships is 10 years for wholesale customers and 5 years for retail distributor relationships, and these intangible assets are being amortized using an economic consumption method to reflect diminishing cash flows from these relationships in the future. The estimated useful life of termination partner relationships is 5 years and is being amortized using an economic consumption method. The estimated useful life of technology is 5 years and is being amortized on a straight-line basis.

*Valuation of Long-lived Assets.* Valuation of certain long-lived assets including property and equipment, intangible assets, and goodwill requires significant judgment. Assumptions and estimates are used in determining the fair value of assets acquired and liabilities assumed in a business combination. A significant portion of the purchase price in the KPN Transaction was assigned to intangible assets and goodwill. Assigning value to intangible assets requires that we use significant judgment in determining (i) the fair value; and (ii) whether such intangibles are amortizable or non-amortizable and, if the former, the period and the method by which the intangible assets will be amortized. We utilize commonly accepted valuation techniques, such as the income approach and the cost approach, as appropriate, in establishing the fair value of long-lived assets. Typically, key assumptions include projected revenue and expense levels used in establishing the fair value of business acquisitions as well as discount rates based on an analysis of our weighted average cost of capital, adjusted for specific risks associated with the assets. Changes in the initial assumptions could lead to changes in amortization expense recorded in our future financial statements.

For intangible assets and property and equipment, we assess the carrying value of these assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include but are not limited to the following:

- significant decline in the share price of our common stock and our overall market capitalization;
- significant underperformance relative to expected historical or projected future operating results;
- significant negative industry or economic trends; or
- significant changes or developments in strategy or operations which affect our intellectual or tangible properties.

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Should we determine that the carrying value of long-lived assets and intangible assets may not be recoverable, we will measure any impairment based on the current fair value of the assets calculated using a projected discounted cash flow with the discount rate determined by management to be commensurate with the risk inherent in our current business model. Significant judgments are required to estimate future cash flows, including the selection of appropriate discount rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for these assets.

We perform annual reviews for impairment of goodwill, or whenever events or changes in circumstances would more likely than not reduce the fair value of a reporting unit below its carrying value. We also perform reviews for impairment for other long-lived assets whenever events or changes in circumstances indicate that the carrying value of these other long-lived assets may not be recoverable. Goodwill may be considered to be impaired if we determine that the carrying value of the reporting unit, including goodwill, exceeds the reporting unit's fair value. Assessing the impairment of goodwill requires us to make certain significant assumptions, estimates and judgments including future revenue, expenses and cash flows, discount rates and control premiums relative to the fair value of the net assets of our reporting units. We estimate the fair value of our reporting units using a combination of valuation techniques, including discounted cash flows, and compare the values to our estimated overall market capitalization. The actual results may differ from these assumptions and estimates and it is possible that such differences could have a material impact on our financial statements. We based the valuation of our Trading reporting unit, in part, on i) our actual historical performance; ii) our estimate of the future performance of our Trading reporting unit and iii) projections developed by an independent analyst. For further information regarding our impairment analysis of goodwill and other intangible assets, see Note 8, *Goodwill and Other Intangible Assets*, in the Notes to Consolidated Financial Statements.

*Income Taxes.* We utilize the liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ("SFAS 109"), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities.

We record a valuation allowance to reduce our deferred tax assets to the amount that we believe is more likely than not to be realized. In assessing the need for a valuation allowance, we consider all positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and recent financial performance. Forming a conclusion that a valuation allowance is not required is difficult when there is negative evidence such as cumulative losses in recent years. As a result of our cumulative losses in the U.S. and the inavailability of loss carryback opportunities, we have concluded that a valuation allowance against the full amount of our net deferred tax assets is appropriate in such jurisdictions. In addition, we have a valuation allowance related to tax benefits from stock option exercises which will increase equity when recognized, and loss carry forwards acquired in the acquisition of KPN GCS (a reverse acquisition), the recognition of which will reduce goodwill.

In certain other foreign jurisdictions where we do not have cumulative losses, we may record valuation allowances to reduce our net deferred tax assets to the amount we believe is more likely than not to be realized. In the future, if we realize a deferred tax asset that currently carries a valuation allowance, we may record a reduction to income tax expense in the period of such realization.

In July 2006, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109* ("FIN 48"), which requires income tax positions to meet a more-likely-than-not recognition threshold to be recognized in the financial statements. Under FIN 48, tax positions that previously failed to meet the more-likely-than-not threshold should be recognized in the first subsequent financial reporting period in

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which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met. Prior to 2007 we recorded estimated income tax liabilities to the extent they were probable and could be reasonably estimated.

Judgment is required in determining our income tax provision. In the ordinary course of conducting a global business enterprise, there are many transactions and calculations undertaken whose ultimate tax outcome cannot be certain. Some of these uncertainties arise as a consequence of transactions and arrangements made among related parties, transfer pricing for transactions with our subsidiaries, and potential challenges to nexus and credit estimates. As a multinational corporation, we are subject to taxation in many jurisdictions, and the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in various taxing jurisdictions. Although we believe our judgments are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from what is reflected in our historical income tax provisions, returns and accruals. Such differences, or changes in estimates relating to potential differences, could have a material impact, unfavorable or favorable, on our income tax provision and operating results in the period in which such a determination is made. If we ultimately determine that the payment of a liability will be unnecessary, we reverse the liability and recognize a tax benefit during the period in which we determine the liability no longer applies. Conversely, we record additional tax charges in a period in which we determine that an assessment is greater than the recorded liability.

## Results of Operations

The following table sets forth for the periods indicated the principal items included in the Consolidated Statements of Operations as percentages of net revenue.

	<b>Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Net revenue from external parties	82.9%	79.0%	74.3%
Net revenue from related parties	17.1	21.0	25.7
Total net revenue	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Costs and operating expenses:			
Data communications and telecommunications costs—external parties	81.7	78.1	70.5
Data communications and telecommunications costs—related parties	8.0	12.2	16.5
Engineering and network operations expenses	1.8	1.4	1.1
Selling, general and administrative expenses	5.6	4.1	3.6
Merger related expenses	—	0.2	—
Depreciation and amortization	2.5	1.4	0.7
Impairment of goodwill	16.2	—	—
Total costs and operating expenses	<u>115.8</u>	<u>97.4</u>	<u>92.4</u>
Income (loss) from operations	(15.8)	2.6	7.6
Interest income (expense), net	(0.1)	0.1	0.0
Foreign exchange gain (loss)	0.2	(0.1)	(0.2)
Other income	0.1	—	—
Income (loss) before income taxes	<u>(15.5)</u>	<u>2.6</u>	<u>7.4</u>
Income tax expense	2.0	0.9	2.2
Net income (loss)	<u>(17.5)%</u>	<u>1.7%</u>	<u>5.2%</u>

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**Year Ended December 31, 2008 Compared to Year Ended December 31, 2007**

Results of operations for the year ended December 31, 2008 includes the results of the combined company following the closing of the KPN Transaction on October 1, 2007. Results of operations for the year ended December 31, 2007 includes the results of operations of KPN GCS only for the first nine months of 2007 and the results of the combined company for the fourth quarter of 2007. As a result, revenue and operating expenses for the year ended December 31, 2008 increased substantially over the year ended December 31, 2007.

*Net revenue.* Our primary source of revenue from external parties are the fees that we charge customers for completing voice and fax calls over our network. We charge our customers fees, per minute of traffic, that are dependent on the length and destination of the call and recognize this revenue in the period in which the call is completed. Revenue from related parties consists of fees that we charge KPN and its affiliates for the traffic they send to us to complete over our network. The fees that we charge KPN and its affiliates are based on the pricing in established service level agreements or other pricing arrangements. Our average revenue per minute ("ARPM") is based upon our total net revenue divided by the number of minutes of traffic over our network for the applicable period. ARPM is a key telecommunications industry financial measurement. We believe this measurement is useful in understanding our financial performance, as well as industry trends. Although the long distance telecommunications industry has been experiencing declining prices in recent years due to the effects of deregulation and increased competition, our average revenue per minute can fluctuate from period to period as a result of shifts in traffic over our network to higher priced, or lower priced, destinations.

Total revenue was \$1,323.6 million for 2008 compared to \$938.6 million for 2007. Revenue from external parties was \$1,097.5 million in 2008 compared to \$741.3 million in 2007. The significant increase in revenue from external parties reflects the combination of iBasis and KPN GCS for all of 2008, compared to 2007, where the first nine months included only the revenue of KPN GCS. The strengthening of the euro against the US dollar during 2008 resulted in a 6.5% increase, or approximately \$36 million, in the US dollar amount of our euro-based revenue. In addition, the TDC Transaction contributed to revenue from external parties in 2008.

During the second half of 2008, we saw a decline in our Trading revenue from external customers relative to the first half of the year. We believe this decline reflected the downturn in the U.S. prepaid calling card market as traffic we receive from prepaid calling card providers and certain wholesale Trading customers whose traffic comes from prepaid calling card providers, declined significantly. The downturn in the U.S. prepaid calling card market is primarily a result of the effect of the current adverse economic conditions in the U.S. on immigrant communities that comprise the majority of this market.

Revenue from related parties in 2008 was \$226.1 million, compared to \$197.3 million in 2007. The higher revenue primarily reflects an increase in traffic from KPN' mobile entities, as well as the effect of the stronger euro against the U.S. dollar, during 2008.

Minutes of traffic in 2008 were 23.5 billion minutes compared to 13.1 billion minutes for 2007. Average revenue per minute was 5.63 cents per minute in 2008 compared to 7.18 cents per minute in 2007.



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For the year ended December 31, 2008, the breakdown of minutes, total revenue and gross profit, which is total revenue less data communications and telecommunications costs, and gross margin percent is as follows:

	<u>Revenue</u>	<u>Gross Profit</u>	<u>Gross Margin</u>	<u>Minutes</u>
	(In millions)		(%)	(In billions)
Trading	\$ 985.0	\$ 80.6	8.2%	18.6
Outsourcing	242.0	42.9	17.7%	2.6
Retail	96.6	12.8	13.3%	2.3
Total	<u>\$1,323.6</u>	<u>\$136.3</u>	<u>10.3%</u>	<u>23.5</u>

*Data communications and telecommunications costs.* Data communications and telecommunications costs are composed primarily of termination and circuit costs. Termination costs are paid to local service providers, or to KPN and its affiliates, to terminate voice and fax calls received from our network. Termination costs are negotiated with the local service providers and termination costs for traffic we send to KPN and its affiliates are based primarily on pricing in service level agreements. Circuit costs primarily include fees for connections between our network and our customers and/or service provider partners and charges for Internet access at our Internet Central Offices.

Total data communications and telecommunications costs were \$1,187.3 million in 2008, compared to \$847.4 million in 2007. Data communications and telecommunications costs from external parties were \$1,081.5 million in 2008, compared to \$733.2 million in 2007. The increase primarily relates to the increase in total revenue in 2008 compared to 2007. Data communications and telecommunications costs from related parties were \$105.8 million in 2008, compared to \$114.2 million in 2007. The lower costs from related parties were primarily due to the closing of an interconnection with a KPN affiliate and lower pricing associated with the service level agreements established with KPN for 2007. As a percentage of total net revenue, total data communications and telecommunications costs were 89.7% in 2008 compared to 90.3% in 2007.

*Engineering and network operations expenses.* Engineering and network operations expenses include the expenses associated with developing, operating and supporting our network and expenses for operating our network operations centers. Also included in this category are engineering expenses incurred in developing, enhancing and supporting our network and our proprietary software applications. Engineering and network operations support of our TDM network are provided by KPN and charged to us under a service level agreement.

Engineering and network operations expenses were \$23.3 million for 2008 compared to \$13.2 million for 2007. The significant increase in expenses in 2008 reflects the combination of iBasis and KPN GCS for all of 2008, compared to 2007 where the first nine months included only the expenses of KPN GCS. Costs related to our service level agreement with KPN in 2008 were \$2.2 million lower compared to 2007.

*Selling, general and administrative expenses.* Selling, general and administrative expenses include salaries, payroll tax and benefit expenses, and other costs for sales and marketing functions and general corporate functions, including executive management, finance, legal, facilities, information technology and human resources. KPN has historically provided certain corporate functions, including finance, information technology and human resources, and charged KPN GCS for this support under a service level agreement.

Selling, general and administrative expenses were \$74.8 million in 2008, compared to \$38.4 million in 2007. The significant increase in expenses in 2008 reflects the combination of iBasis and KPN GCS



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for all of 2008, compared to 2007 where the first nine months included only the expenses of KPN GCS. This increase was partially offset by lower costs related to service level agreement with KPN during 2008. Since the date of the KPN transaction, as part of our integration process, we have reduced the level of services and support required from KPN for our Netherlands operations. In certain cases, such as audit fees, we are now directly responsible for these costs. As a result of our integration efforts to-date, selling, general and administrative costs incurred directly from KPN in 2008 were reduced by \$10.8 million from 2007. In 2008, we capitalized approximately \$1.2 million in costs associated with the development of software used internally by the Company. In 2007, costs associated with the development of software used internally by the Company which were capitalized were insignificant. In addition, we incurred \$1.0 million in costs in 2008 related to a potential transaction that we discontinued pursuing.

In the fourth quarter of 2007, we took a charge of \$2.6 million related to retroactive Universal Service fund and other regulatory fees, relating to our prepaid calling service revenue prior to July 2006. This charge resulted from a decision by the U.S. Court of Appeals, in early December 2007, which denied our appeal of the retroactive aspect of a Federal Communications Commission order issued in June 2006.

*Merger related expenses.* There were no merger related expenses in 2008. Merger related expenses of \$2.0 million in 2007 primarily relate to costs incurred for the preparation and review of the historical financial statements of KPN GCS in anticipation of the transaction with iBasis. These costs were paid by KPN but are reflected in our results of operations for 2007.

*Depreciation and amortization expenses.* Depreciation and amortization expenses were \$32.0 million in 2008, compared to \$12.7 million in 2007. Amortization expense in 2008 includes \$16.7 million in amortization of identified intangible assets, including \$15.4 million for identified intangible assets resulted from the allocation of the purchase price of iBasis to the fair value of iBasis' net assets as of October 1, 2007 and \$1.3 million for intangible assets resulting from the TDC Transaction in 2008. Depreciation and amortization expense in 2007 also included a \$1.8 million charge in the fourth quarter of 2007 for the write-off of certain costs previously capitalized by KPN GCS.

*Impairment of goodwill.* Subsequent to the end of the third quarter of 2008, we experienced a sharp decline in our stock price. We believe this decline was principally driven by circumstances that occurred subsequent to the end of the third quarter including, but not limited to, an extraordinary decline in the stock market as a whole and other factors specific to our stock price. As a result, when we performed our annual impairment test as of December 31, 2008, we determined that we had an impairment loss on goodwill of \$214.7 million. Since December 31, 2008, our market capitalization has continued to decline. As a result, it is reasonably possible that there could be an impairment of our intangible assets and/or our remaining goodwill in the near term and the amounts could be material. For further information on our annual impairment test of goodwill, see Note 8, *Goodwill and Other Intangible Assets*, in the Notes to Consolidated Financial Statements.

*Interest income.* Interest income was \$2.1 million in 2008, compared to \$1.7 million in 2007. The increase in interest income primarily relates to higher average cash balances in 2008, partially offset by lower interest rates.

*Interest expense.* Interest expense was \$3.0 million in 2008, compared to \$0.7 million in 2007. Interest expense in 2008 includes interest on bank borrowings and capital leases, as well as interest of \$1.0 million on the amount due to KPN for the post-closing working capital adjustment.

*Foreign exchange gain (loss), net.* Foreign exchange gain, net was \$3.1 million in 2008, compared to a foreign exchange loss of \$1.1 million in 2007. The foreign exchange gain in 2008, as well as the

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foreign exchange loss in 2007, was primarily a result of the change in exchange rates between the euro and U.S. dollar on our euro-denominated assets and liabilities.

*Other income.* Other income of \$1.8 million in 2008 reflects a one-time benefit relating to the reversal of a liability for which the statute of limitations had expired. This liability related to traffic termination costs claimed by a bankrupt carrier.

*Income taxes.* Income tax expense was \$26.3 million in 2008 compared to \$8.5 million in 2007. In 2008, we recorded an additional non-cash income tax expense of \$16.8 million as a result of the utilization of previously reserved pre-acquisition net operating loss carry-forwards. The use of these pre-acquisition net operating losses cannot reduce income tax expense but, instead, must reduce the carrying value of goodwill. This additional income tax expense does not represent income tax payments we will have to make now, or at any time in the future. Effective January 1, 2009, with the adoption of FAS 141R, such pre-acquisition net operating losses will reduce income tax expense, when utilized or when the valuation allowance for such net operating losses is released.

The balance of the 2008 income tax expense of \$9.5 million, and the tax expense of \$8.5 million in 2007, primarily relates to income taxes on the taxable income of our Netherlands operations.

### **Year Ended December 31, 2007 Compared to Year Ended December 31, 2006**

Results of operations for the year ended December 31, 2007 includes the results of operations of KPN GCS only for the first nine months of 2007 and the results of the combined company following the closing of KPN Transaction on October 1, 2007, for the fourth quarter of 2007. Results of operations for the year ended December 31, 2006 are the results of operations of KPN GCS only. As a result, revenue and operating expenses for the year ended December 31, 2007 increased substantially.

*Net revenue.* Total revenue was \$938.6 million for 2007 compared to \$814.2 million for 2006. Revenue from external parties was \$741.3 million in 2007 compared to \$605.0 million in 2006. The increase in revenue from external parties reflects a combination of the strengthening of the euro against the US dollar and the inclusion of iBasis revenue of \$143.9 million for the fourth quarter of 2007. As the revenue of KPN GCS is primarily denominated in euros, the stronger euro in 2007 resulted in an increase in revenue from external parties of approximately 8% in U.S. dollars in 2007. Excluding the effect of the stronger euro in 2007 and the inclusion of iBasis revenue for the fourth quarter of 2007, revenue from external parties declined approximately 9% from 2006. The decrease was primarily due to the focus on maximizing margins in 2007, which resulted in a decrease in revenue and minutes from lower margin traffic.

Revenue from related parties in 2007 was \$197.3 million, compared to \$209.2 million in 2006. The lower revenue primarily reflects the pricing in service level agreements established between KPN GCS and KPN in mid 2006, in anticipation of the completion of the KPN Transaction. Prior to these new service level agreements, KPN GCS had more favorable pricing arrangements with KPN.

Minutes of traffic in 2007 were 13.1 billion minutes compared to 9.0 billion minutes in 2006. Excluding the effect of the inclusion of iBasis traffic for the fourth quarter of 2007, minutes of traffic increased by 0.5 billion minutes, or 5%, in 2007 over 2006. Average revenue per minute was 7.18 cents per minute in 2007 compared to 9.02 cents per minute in 2006.

*Data communications and telecommunications costs.* Total data communications and telecommunications costs were \$847.4 million in 2007, compared to \$708.3 million in 2006. Data communications and telecommunications costs from external parties were \$733.2 million in 2007, compared to \$574.0 million in 2006. This increase was primarily due to the effect of the stronger euro, compared to the U.S. dollar, in 2007 on KPN GCS's euro-denominated costs and the inclusion of iBasis costs of \$126.4 million for the fourth quarter of 2007. Data communications and

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telecommunications costs from related parties were \$114.2 million in 2007, compared to \$134.3 million in 2006. The lower costs from related parties were primarily due to the closing of an interconnection with a KPN affiliate and lower pricing associated with the service level agreements established with KPN for 2007. As a percentage of total net revenue, total data communications and telecommunications costs were 90.3% in 2007 compared to 87.0% in 2006.

*Engineering and network operations expenses.* Engineering and network operations expenses were \$13.2 million for 2007 compared to \$8.9 million for 2006. The higher expenses in 2007 relate to the costs of iBasis' engineering and network operations expenses of \$4.8 million for the fourth quarter of 2007, partially offset by lower charges under the service level agreement between KPN and KPN GCS in 2007, compared to 2006.

*Selling, general and administrative expenses.* Selling, general and administrative expenses were \$38.4 million in 2007, compared to \$29.8 million in 2006. The increase in 2007 primarily reflects the inclusion of the selling, general and administrative costs of iBasis of \$16.9 million for the fourth quarter of 2007. In addition, the stronger euro compared to the U.S. dollar resulted in an increase in the euro-denominated expenses of KPN GCS. These increases were partially offset by lower costs in the 2007 service level agreement for support from KPN. In addition, in the fourth quarter of 2007, we took a charge of \$2.6 million related to retroactive Universal Service fund and other regulatory fees, relating to our prepaid calling service revenue prior to July 2006. This charge resulted from a decision by the U.S. Court of Appeals, in early December 2007, which denied our appeal of the retroactive aspect of a Federal Communications Commission order issued in June 2006.

*Merger related expenses.* Merger related expenses of \$2.0 million in 2007 primarily relate to costs incurred for the preparation and review of the historical financial statements of KPN GCS in anticipation of the transaction with iBasis. These costs have been paid by KPN but are reflected in our results of operations for 2007.

*Depreciation and amortization expenses.* Depreciation and amortization expenses were \$12.7 million in 2007, compared to \$5.7 million in 2006. Amortization expense in 2007 includes \$3.9 million in amortization of identified intangible assets. These identified intangible assets resulted from the allocation of the purchase price of iBasis to the fair value of iBasis' net assets as of October 1, 2007. Depreciation and amortization expense in 2007 also included a \$1.8 million charge in the fourth quarter of 2007 for the write-off of certain costs previously capitalized by KPN GCS.

*Interest income.* Interest income was \$1.7 million for 2007, compared to \$0.3 million in 2006. The increase in interest income primarily relates to higher average cash balances in 2007.

*Interest expense.* Interest expense was \$0.7 million in 2007, compared to \$32,000 in 2006. Interest expense in 2007 includes interest of \$0.5 million on bank borrowings of \$25.0 million early in the fourth quarter of 2007 under our line of credit with Silicon Valley Bank.

*Foreign exchange loss, net.* Foreign exchange loss, net was \$1.1 million in 2007, compared to \$1.3 million in 2006. These foreign exchange losses are primarily a result of the change in exchange rates between the euro and U.S. dollar on foreign currency contracts.

*Income taxes.* The income tax provision of \$8.5 million in 2007 and \$17.9 million in 2006 primarily relates to income taxes on the taxable income of The Netherlands operations of KPN GCS. The effective tax rate in 2007 and 2006 was 34.6% and 29.6%, respectively. The higher effective tax rate in 2007 is due to U.S. operating losses for which there is no current tax benefit. The effective tax rate in 2006 approximates the statutory rate in The Netherlands.

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## Liquidity and Capital Resources

Prior to October 1, 2007, KPN GCS operated from inception as an integrated part of KPN and within the KPN infrastructure. KPN uses a centralized approach to cash management and financing of its operations. Historically, cash was remitted to KPN on a regular basis and cash disbursements were funded from KPN cash accounts on behalf of KPN GCS. Cash remittances to KPN, net of disbursements by KPN on behalf of KPN GCS, are reflected as net distributions to related parties in the Consolidated Statements of Stockholders' Equity.

Cash provided by operating activities of \$33.0 million in 2008 was primarily the result of the net loss of \$231.0 million, offset by non-cash charges of \$267.5 million. Non-cash charges in 2008 included impairment of goodwill of \$214.7 million, depreciation and amortization of \$32.0 million, non-cash income tax expense relating to the utilization of pre acquisition net operating losses of \$16.8 million, stock-based compensation of \$2.5 million and a provision for doubtful accounts receivable of \$1.6 million. During 2008, cash was used in operating activities for changes in other assets and liabilities of \$3.5 million. Changes in other assets and liabilities included a payment of \$7.6 million related to 2007 income taxes due for KPN GCS. Excluding the prior year tax payment of \$7.6 million, changes in operating assets and liabilities provided \$4.1 million in cash and cash flow from operating activities for 2008 was \$40.6 million.

Cash provided by operating activities of \$58.1 million in 2007 was primarily the result of net income of \$16.1 million, non-cash charges of \$13.2 million, primarily depreciation and amortization, and changes in other assets and liabilities of \$28.8 million. Changes in other assets and liabilities included a decline in accounts receivable—external parties of \$22.7 million and in accounts receivable—related parties of \$33.8 million, partially offset by a decline in accounts payable of \$32.2 million.

Cash provided by operating activities in 2006 of \$32.5 million was the result of net income of \$42.5 million, non-cash charges of \$5.7 million for depreciation and amortization, and changes in other assets and liabilities of \$(15.7) million. Changes in other assets and liabilities in 2006 included an increase in accounts receivable—related parties of \$25.1 million and a decrease in accounts payable of \$43.6 million, partially offset by a decrease in accounts receivable—external parties of \$37.0 million.

Cash used in investing activities in 2008 was \$20.0 million. Additions to property and equipment were \$16.0 million in 2008. On April 1, 2008, we acquired certain assets from TDC, the leading telecommunications carrier in Denmark, as well as certain assets, contracts and employees of TDC's subsidiary in the U.S., TDC Carrier Services U.S., for approximately \$11.0 million in cash. Cash provided by investing activities included a reduction in other assets, relating to investing activities, of \$5.0 million and maturities of short-term marketable securities of \$2.0 million.

Cash provided by investing activities in 2007 of \$42.1 million included the acquisition of \$54.7 million of existing cash and cash equivalents of iBasis on the date of the closing of the KPN Transaction. Additions to property and equipment were \$9.6 million in 2007 and maturities of short-term marketable securities were \$2.0 million. The increase of \$5.0 million in other assets relates to other investing activities.

Cash used in investing activities in 2006 of \$3.9 million relate to additions to property and equipment.

Cash used in financing activities in 2008 was \$19.0 million. We used \$15.0 million in cash for the purchase of our common stock under a stock repurchase program, \$1.6 million in payments of capital lease obligations and \$0.3 million in dividend payments on the exercise of warrants. During 2008, we borrowed, net, an additional \$2.1 million under our Loan Agreement with Silicon Valley Bank and received \$0.6 million in proceeds on the exercise of stock options. In addition, we paid \$4.7 million of the \$14.7 million due to KPN for the post closing working capital adjustment.

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Cash used in financing activities in 2007 was \$61.1 million and included \$55.0 million paid by KPN as partial consideration for the acquisition of 51% of the outstanding shares of iBasis on October 1, 2007. In early October, following the completion of the KPN Transaction, we paid a \$113.0 million dividend to iBasis shareholders of record immediately preceding the closing of the KPN Transaction. In addition, we paid \$0.5 million in dividends to warrant holders who exercised their warrants during the fourth quarter of 2007. Net distributions to KPN in 2007 were \$27.8 million. In the fourth quarter of 2007, we borrowed \$25.0 million under our second amended and restated loan and security agreement with Silicon Valley Bank. Proceeds from exercises of stock options and warrants were \$0.5 million in 2007 and payments of capital lease obligations were \$0.4 million.

Cash used in financing activities in 2006 was \$28.9 million and consisted of net distributions to KPN of \$27.9 million and payment of a note payable to a KPN affiliate of \$1.0 million.

In April 2008, we announced that our board of directors had approved a stock repurchase program, authorizing us to purchase up to \$15.0 million of our common stock over the next six months. Between May and August 2008, we completed this program by purchasing 3.9 million shares of our common stock for a total cost of \$15.0 million, as set forth in the table below. The repurchases were made in the open market and in privately negotiated purchases. The timing and amount of the shares we purchased were determined by our management based on our evaluation of market conditions and other factors. No shares were purchased from KPN as part of this program.

<u>Period</u>	<u>Total Shares Purchased</u>	<u>Average Price Paid per Share</u>
May 1, 2008–May 31, 2008	886,300	\$ 3.33
June 1, 2008–June 30, 2008	536,100	\$ 3.58
July 1, 2008–July 31, 2008	331,400	\$ 3.71
August 1, 2008–August 31, 2008	2,153,140	\$ 4.14
Total	<u>3,906,940</u>	<u>\$ 3.84</u>

In accordance with the Share Purchase Agreement for the KPN Transaction, a post-closing adjustment was required if (i) iBasis' working capital was lower than or exceeded \$37,100,000; (ii) iBasis' debt exceeded or was lower than \$2,900,000; (iii) the combined working capital of KPN GCS was lower than or exceeded (\$6,100,000); and/or (iv) the combined debt of KPN GCS exceeded \$0, as of the date of the closing of the KPN Transaction. Based on iBasis' balance sheet position on the date of the closing of the KPN Transaction, working capital was \$13,353,000 less than the specified level of \$37,100,000, and debt was \$1,776,000 less than the specified level of \$2,900,000. As a result, a payment of \$11,577,000 is due to KPN from iBasis. Based on KPN GCS's balance sheet position on the date of the closing of the KPN Transaction, working capital exceeded the specified level of (\$6,100,000) by \$3,945,000 and debt was at the specified level of \$0. As a result, payment of \$3,945,000 was due to KPN from iBasis.

In 2008, KPN forgave \$0.8 million in expenses incurred by KPN GCS since the closing of the KPN Transaction. As a result, the amount due to KPN has been reduced by this amount and was recorded as a contribution to equity. These expenses have been recorded in our results of operations. The total amount of \$14.7 million due to KPN was scheduled to be paid by iBasis in three successive quarterly installments through the third quarter of 2008, with interest at the rate of 6% per annum. In May 2008, we made the first payment of \$5.2 million, including interest, to KPN. In September 2008, we revised the terms of the remaining balance of \$10.3 million due to KPN to extend the payment date on the second installment payment to March 2009 and the final installment to June 2009. In addition, the interest rate was increased to 7% on the principal amount due, effective October 1, 2008, and we paid additional interest of \$60,000 relating to the extension of the second installment that was due June 30, 2008.

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As of December 31, 2008 and 2007, unpaid principal and accrued interest due to KPN was \$10.5 million and \$15.5 million, respectively.

In October 2007, we entered into a Second Amended and Restated Loan and Security Agreement (the "Loan Agreement") with Silicon Valley Bank, which amended and restated a certain Amended and Restated Loan and Security Agreement dated as of December 29, 2003. We entered into the Loan Agreement to obtain funding for working capital purposes and in support of the KPN Transaction. Pursuant to the Loan Agreement, which was subsequently amended as described below, we could borrow up to \$35.0 million from time to time under a secured revolving credit facility for a two-year period. Except as described below, borrowings under the Loan Agreement are on a formula basis, based on eligible domestic and foreign accounts receivable. The Loan Agreement contains quarterly financial covenants, consisting primarily of minimum profitability and minimum liquidity requirements. Interest on borrowings under our Loan Agreement were based, in part, on our quarterly profitability, with the maximum interest rate being the bank's prime rate, plus 0.5%, or LIBOR, plus 2.75%. The Loan Agreement has a quarterly commitment fee of 0.63% on any unused portion of the line of credit and we paid an up-front, one-time facility fee of 0.75%, or \$263,000. The Loan Agreement is also guaranteed by all our domestic wholly-owned subsidiaries and is collateralized by a first priority lien and security interest on our and such guarantor's assets. In addition, we pledged 66.2% of all of our ownership in KPN Global Carrier Services (now known as iBasis Netherlands), a wholly-owned subsidiary based in The Netherlands, as collateral. Pursuant to the terms of the Loan Agreement, we may use the proceeds solely (i) for working capital, (ii) to fund our general business requirements, and (iii) to fund the dividend paid by us in connection with the KPN Transaction.

In April 2008, we modified the Loan Agreement to increase our maximum borrowing availability from \$35.0 million to \$50.0 million. In addition, to reflect our current operating results and financial position, we modified the minimum profitability financial covenant and added a minimum cash flow financial requirement pursuant to a sliding scale that decreases over time. A portion of the additional \$15.0 million in funds is subject to a non-formula borrowing base through February 2009. The modification also permitted us to repurchase up to \$15 million shares of our common stock under a stock repurchase program approved by our board of directors in April 2008. We paid an up-front, one-time supplemental commitment fee of \$150,000 and an up-front, one-time modification fee of \$75,000.

In September 2008, we modified the financial covenants under the Loan Agreement to reflect our current operating results and financial position as follows:

- (i) We reduced the minimum profitability covenant for the quarter ended September 30, 2008;
- (ii) We reduced the minimum liquidity covenant for the quarter ended September 30, 2008 through February 2009; and
- (iii) We replaced the minimum cash flow covenant with a requirement to maintain at least \$10 million in combined cash and borrowing availability with Silicon Valley Bank for the quarter ended September 30, 2008 through February 2009, and increasing to \$15 million thereafter.

In addition, the interest rate on borrowings under the Loan Agreement was increased by 1% per annum and we paid an up-front, one-time modification fee of \$125,000. At September 30, 2008, we were in compliance with all of the financial covenants, as modified in September 2008, under the Loan Agreement.



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On January 26, 2009, the Company and Silicon Valley Bank modified the Loan Agreement, effective as of December 30, 2008. The modification to the Loan Agreement contains the following amendments, among others:

- (i) We decreased the amount available under the Loan Agreement from \$50.0 million to \$35.0 million;
- (ii) We extended the maturity date of the Loan Agreement to September 30, 2010;
- (iii) We established minimum interest rates payable on amounts drawn under the Loan Agreement, which include an interest rate floor of 4.25% on amounts subject to Silicon Valley Bank's prime rate and an interest rate floor of 2.0% on amounts subject to the LIBOR rate;
- (iv) We changed formulas for determining quarterly adjustments to margins applicable to prime rate and LIBOR rate and formula for unused revolving line fee from formulas based on the total funded debt ratio to formulas based on EBITDA (earnings before interest, taxes, depreciation and amortization) minus capital expenditures;
- (v) We increased the frequency of certain financial reporting requirements from quarterly to monthly as requested by Silicon Valley Bank;
- (vi) We modified the minimum adjusted quick ratio financial covenant to require a minimum adjusted quick ratio of 0.80 to 1.00 for the fiscal quarter ended December 31, 2008 and as of the end of each fiscal quarter thereafter;
- (vii) We deleted the minimum consolidated EBITDA financial covenant;
- (viii) We added a financial covenant requiring consolidated EBITDA minus capital expenditures to be at least (a) (\$1,000,000) with respect to the fiscal quarters ending December 31, 2008 and March 31, 2009, (b) \$1.00 with respect to the fiscal quarter ending June 30, 2009, (c) \$1,750,000 with respect to the fiscal quarter ending September 30, 2009, and (d) \$3,500,000 with respect to the fiscal quarter ending December 31, 2009 and each fiscal quarter thereafter; and
- (ix) We modified the minimum liquidity financial covenant to require a minimum liquidity amount of \$17.5 million measured at the end of each fiscal month through August 31, 2009 and a minimum of \$20 million at the end of each fiscal month thereafter. In addition, we are required to maintain at least 40% of our total cash, cash equivalents and short-term investments with Silicon Valley Bank.

As of December 31, 2008, we were in violation of our minimum profitability covenant under the Loan Agreement. However, Silicon Valley Bank subsequently waived non-compliance of this covenant in the form of the modification to the Loan Agreement executed on January 26, 2009. In connection with this modification, we paid Silicon Valley Bank a modification fee of \$52,500 and a revolving line renewal fee of \$175,000.

At December 31, 2008 and 2007, we had \$27.1 million and \$25.0 million, respectively, in borrowings outstanding, and had issued outstanding standby letters of credit of \$2.6 million and \$2.9 million, respectively, under the Loan Agreement.

To further capture cost savings from our integration efforts, we are restructuring our operations in The Netherlands. We expect that our operations in The Netherlands will become primarily sales and product management, with strategic support from locations outside The Netherlands. As this plan has not yet been finalized, we cannot yet determine the amount of any future restructuring charges we may incur and the timing of such charges. In addition, in the future, we will be further reducing the operational services we purchase from KPN as integration projects are completed.

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We anticipate that the December 31, 2008 balance of \$56.9 million in cash and cash equivalents, together with expected net cash flow generated from operations and bank borrowing availability, will be sufficient to fund our operations and capital asset expenditures for the next twelve months. We expect capital asset expenditures to be approximately \$15.0 million in 2009.

### **Year Ended December 31, 2008 Compared to Unaudited Pro Forma Year Ended December 31, 2007**

The following table presents our results of operations for the year ended December 31, 2008 compared to our pro forma combined results of operations for the year ended December 31, 2007. The comparison of our results of operations for the year ended December 31, 2008 compared to pro forma combined results of operations for the year ended December 31, 2007 is being provided as supplemental information. We believe the comparison of our results of operations for the year ended December 31, 2008 to the pro forma combined results of operations for the year ended December 31, 2007 is a more meaningful comparison than the comparison to our actual results of operations for the year ended December 31, 2007, as these results contain the historical results of KPN GCS for the first nine months of 2007 and the results of the combined company for the fourth quarter of 2007.

The pro forma results of operations for the year ended December 31, 2007 reflect the combined historical results of iBasis and KPN GCS as if the KPN Transaction had occurred as of the beginning of this period, including certain pro forma adjustments. These pro forma adjustments include amortization expense of \$11.0 million related to certain intangible assets resulting from the KPN Transaction, and the elimination of \$2.9 million in revenue and data communications and telecommunications costs for revenue transactions between iBasis and KPN GCS during the period of 2007 prior to the KPN Transaction.

	<b>Year Ended December 31, 2008</b>	<b>Unaudited Pro Forma Year Ended December 31, 2007</b>
	<b>(In millions, except per share data)</b>	
Total net revenue	\$ 1,323.6	\$ 1,390.6
Data communications and telecommunications costs	1,187.3	1,248.2
Gross profit*	136.3	142.4
Gross margin	10.3%	10.2%
Engineering and network operations and selling, general and administrative expenses	98.2	101.4
Depreciation and amortization	32.0	30.1
Impairment of goodwill	214.7	—
Income (loss) from operations	(208.6)	10.9
Net income (loss)	\$ (231.0)	\$ 3.9
Basic and diluted net income (loss) per share	\$ (3.15)	\$ 0.10

\* Net revenue less data communications and telecommunications costs.



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Total revenue for the year ended December 31, 2008 of \$1,323.6 million was 5% lower than pro forma revenue of \$1,390.6 million for 2007. The breakdown of total revenue for the year ended December 31, 2008 compared to pro forma year ended December 31, 2008 is as follows:

	Year Ended December 31, 2008	Unaudited Pro Forma Year Ended December 31, 2007
	(In millions)	
Trading	\$ 985.0	\$ 1,082.8
Outsourcing	242.0	197.3
Retail	96.6	110.5
Total	<u>\$ 1,323.6</u>	<u>\$ 1,390.6</u>

The decrease in Trading revenue reflects, in part, the current downturn in the U.S. prepaid calling card market. Traffic we receive from prepaid calling card providers and certain wholesale Trading customers whose traffic comes from prepaid calling card providers, declined significantly in the second half of 2008. The downturn in the U.S. prepaid calling card market is primarily a result of the effect of the current adverse economic conditions in the U.S. on immigrant communities that comprise the majority of this market. Our Outsourcing revenue increased to \$242.0 million for the year ended December 31, 2008 from pro forma \$197.3 million in 2007. The year-over-year increase is due to increased traffic from KPN and its affiliates and the inclusion of the TDC traffic, which began in the second quarter of 2008. Retail revenue declined to \$96.6 million in the year ended December 31, 2008 from pro forma \$110.5 million in 2007. Our Retail revenue was impacted by our transparent pricing initiative in the first half of 2008. In addition, the U.S. recession and changes in immigration patterns flattened our growth year-over-year.

Minutes of traffic were 23.5 billion in the year ended December 31, 2008, approximately flat with pro forma combined minutes of 23.6 billion in 2007. Average revenue per minute was 5.63 cents for the year ended December 31, 2008, compared to pro forma 5.88 cents in 2007. Average cost per minute, defined as total data communications and telecommunications costs divided by minutes of traffic, was 5.05 cents for the year ended December 31, 2008, compared to pro forma 5.28 cents in 2007. Average margin per minute, defined as total revenue less total data communications and telecommunications costs divided by minutes of traffic, was 0.58 cents for year ended December 31, 2008, compared to pro forma 0.60 cents in 2007.

Total operating expenses were \$98.2 million in the year ended December 31, 2008, compared to pro forma \$101.4 million in 2007. Pro forma results for 2007 include \$4.5 million in one-time charges, which included retroactive regulatory fees of \$2.6 million, stock option analysis expenses of \$0.7 million, merger related and purchase accounting adjustments of \$0.9 million and other adjustments of \$0.3 million. Excluding one-time charges in 2007, operating expenses increased slightly in the year ended December 31, 2008 compared to pro forma 2007. The year-to-year increase in expenses primarily reflects investments we have made to integrate the operations of the combined company to achieve operational synergies.

Depreciation and amortization was \$32.0 million in the year ended December 31, 2008, compared to pro forma \$30.1 million in 2007. The increase primarily relates to additions to property and equipment to support our integration efforts, as well as additional amortization of tangible and intangible assets acquired in the TDC transaction on April 1, 2008.

Subsequent to the end of the third quarter of 2008, we experienced a sharp decline in our stock price. We believe this decline was principally driven by circumstances that occurred subsequent to the end of the third quarter including, but not limited to, an extraordinary decline in the stock market as a

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whole and other factors specific to our stock price. As a result, when we performed our annual impairment test as of December 31, 2008, we determined that we had an impairment loss on goodwill of \$214.7 million.

Since December 31, 2008, our market capitalization has continued to decline. As a result, it is reasonably possible that there could be an impairment of our intangible assets and/or our remaining goodwill in the near term and the amounts could be material.

### Off-Balance Sheet Arrangements

Under accounting principles generally accepted in the U.S., certain obligations and commitments are not required to be included in the consolidated balance sheets and statements of operations. These obligations and commitments, while entered into in the normal course of business, may have a material impact on liquidity. We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

### Contractual Obligations

The following table summarizes our future contractual obligations as of December 31, 2008:

	Total	Payment Due Dates				
		Less than 1 Year	1 to 2 Years	2 to 3 Years	3 to 5 Years	After 5 Years
			(In thousands)			
Bank borrowings	\$27,080	\$ —	\$27,080	\$ —	\$ —	\$ —
Interest on bank borrowings(1)	2,369	1,354	1,015	—	—	—
Capital lease obligations	877	577	300	—	—	—
Operating leases	6,140	2,784	877	392	570	1,517
Purchase commitments for termination of minutes	20,543	20,543	—	—	—	—
Total	<u>\$57,009</u>	<u>\$25,258</u>	<u>\$29,272</u>	<u>\$392</u>	<u>\$570</u>	<u>\$1,517</u>

- (1) Interest payment amounts on bank borrowings are projected using market rates as of December 31, 2008. Future interest payments may differ from these projections based on changes in market interest rates.

We adopted FIN 48 as of January 1, 2007. As of December 31, 2008, the total amount of net unrecognized tax benefits for uncertain tax positions and the accrual for the related interest and penalties was \$0.9 million. We are unable to make a reasonably reliable estimate of when cash settlement, if any, will occur with a tax authority as the timing of examinations and ultimate resolution of those examinations is uncertain.

As of December 31, 2008 and 2007, we did not have any material purchase obligations, or other material long-term commitments reflected on our consolidated balance sheet.

### New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, "*Fair Value Measurements*", ("SFAS No. 157"). SFAS No. 157 establishes a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. This accounting standard is effective for financial statements issued for fiscal years beginning after November 15, 2007. However, in

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January 2008, the FASB issued FASB Staff Position FAS 157-b, *Effective Date of FASB Statement No. 157* ("FSP FAS 157-b"). FSP FAS 157-b permits entities to elect to defer the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. We have elected to defer the adoption of SFAS No. 157 for those assets and liabilities included in FSP FAS 157-b. The adoption of SFAS No. 157 did not have a material effect on our financial position, results of operations and cash flows for the year ended December 31, 2008.

On January 1, 2008, we adopted Statement of Financial Accounting Standards (SFAS) No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115" (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which are not otherwise currently required to be measured at fair value. Under SFAS No. 159, the decision to measure items at fair value is made at specified election dates on an instrument-by-instrument basis and is irrevocable. Entities electing the fair value option are required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. The adoption of SFAS No. 159 did not have a material effect on our financial position, results of operations and cash flows for the year ended December 31, 2008.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ("SFAS No. 141R"), *"Business Combinations"* and SFAS No. 160 ("SFAS No. 160"), *"Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51."* SFAS No. 141R will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 141R and SFAS No. 160 are effective beginning the first fiscal quarter of 2009. Early adoption is not permitted. SFAS No. 141R may give rise to more volatility in our results of operations for future acquisitions.

In March 2008, the FASB issued SFAS No. 161 ("SFAS No. 161"), *"Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133."* The standard is intended to enhance the current disclosure framework in Statement 133, Accounting for Derivative Instruments and Hedging Activities. The standard requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. We do not expect the adoption of SFAS No. 161 will have a material effect on our financial position, results of operations and cash flows.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, *"Determination of the Useful Life of Intangible Assets"* ("FSP 142-3"). FSP 142-3 is effective for financial statement issued for fiscal years beginning after December 15, 2008 and interim period within those years. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset, under SFAS No. 142, *"Goodwill and Other Intangible Assets"* ("SFAS No. 142"). FSP 142-3 is intended to improve the consistency between the useful life of an intangible asset determined under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R and other generally accepted accounting principles. We do not expect the adoption of FSP 142-3 to have a material effect on our financial position, results of operations and cash flows.

In May 2008, the FASB issued SFAS ("SFAS No. 162"), *"The Hierarchy of Generally Accepted Accounting Principles."* SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles. SFAS No. 162 becomes effective 60 days

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following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *"The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles."* We do not expect that the adoption of SFAS No. 162 to have a material effect on our financial position, results of operations and cash flows.

### **Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

Our primary market risk exposure is related to interest rates and foreign currency exchange rates. We are exposed to foreign currency risk which can create volatility in earnings and cash flows from period to period. Historically, KPN GCS sought to economically hedge a portion of its foreign currency risk arising from foreign exchange receivables and foreign currency-denominated forecasted transactions. Foreign exchange contracts were used to fix or protect the exchange rate to be used for foreign currency-denominated transactions. Hedge accounting was not applied in the historical financial statements of KPN GCS. We do not currently engage in trading market risk sensitive instruments or purchasing hedging instruments, whether interest rate, foreign currency exchange, commodity price or equity price risk and have not purchased options or entered into swaps or forward or futures contracts.

Our revenues are primarily denominated in U.S. dollars or euros. Thus, we are exposed to foreign currency exchange rate fluctuations as the financial results and balances of our foreign entities are translated into U.S. dollars. As exchange rates vary, these results, when translated, may vary from expectations and may adversely impact our results of operations and financial condition. For example, if the dollar weakens relative to the euro, our euro denominated revenues and expenses would increase when stated in U.S. dollars. Conversely, if the U.S. dollar strengthens relative to the euro, our euro denominated revenues and expenses would decrease.

Our primary interest rate risk is the risk on borrowings under our bank line of credit, which is subject to interest rates based on the bank's prime rate or LIBOR, plus a margin. We had \$27.1 million in borrowings under our bank line of credit at December 31, 2008. A change in the applicable interest rates would also affect the rate at which we could borrow funds or finance equipment purchases. Our capital lease obligations are fixed rate debt.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of iBasis, Inc. and its subsidiaries at December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Notes 1 and 15 to the consolidated financial statements, the Company has entered into significant transactions with Royal KPN N.V. (parent company), a related party.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP  
Boston, Massachusetts  
March 13, 2009

[Table of Contents](#)**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of iBasis, Inc.

In our opinion, the accompanying combined statements of operations, of stockholders equity and of cash flows present fairly, in all material respects, the financial position of KPN GCS (predecessor to iBasis, Inc.) and its subsidiaries, at December 31, 2006, and the results of their operations and their cash flows for the year in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Notes 1 and 15 to the consolidated financial statements, the Company has entered into significant transactions with Royal KPN N.V. (the parent company), a related party.

June 19, 2007, except for Note 2 "Net income (loss) per share" and Note 17 "Foreign currency translation of historical KPN GCS financial statements", as to which the date is March 14, 2008.

PricewaterhouseCoopers Accountants N.V.

/s/ H.C. WÜST RA

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H.C. Wüst RA

[Table of Contents](#)**iBasis, Inc.****Consolidated Balance Sheets**

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(In thousands, except per share data)</b>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 56,912	\$ 63,735
Short-term marketable securities	—	1,999
Accounts receivable and unbilled revenue—external parties, net of allowance for doubtful accounts of \$5,178 and \$12,924, respectively	234,946	204,883
Accounts receivable—related parties	2,053	—
Prepaid expenses and other current assets	6,477	4,687
Total current assets	<u>300,388</u>	<u>275,304</u>
Property and equipment, net	34,836	34,966
Other assets	1,573	7,008
Intangible assets, net	87,206	93,800
Goodwill	17,324	248,795
Total assets	<u>\$ 441,327</u>	<u>\$ 659,873</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable—external parties	\$ 155,676	\$ 135,060
Accounts payable—related parties	—	11,839
Accrued expenses	151,685	136,903
Deferred revenue	13,894	11,503
Current portion of long-term debt	577	755
Total current liabilities	<u>321,832</u>	<u>296,060</u>
Long-term debt, net of current portion	27,380	25,000
Deferred income taxes	2,534	2,942
Other long-term liabilities	1,063	1,381
Total liabilities	<u>352,809</u>	<u>325,383</u>
Commitments and contingencies (Note 14)		
Stockholders' equity		
Preferred stock, \$0.001 par value, authorized—15,000 shares; issued and outstanding;—none	—	—
Common stock, \$0.001 par value, authorized—170,000 shares; issued—76,204 shares and 75,912 shares, respectively; outstanding—71,228 shares and 74,843 shares, respectively	76	76
Treasury stock, 4,976 and 1,069 shares, respectively, at cost	(15,000)	—
Additional paid-in capital	337,590	333,278
Accumulated other comprehensive income (loss)	(1,140)	3,155
Contributed capital/retained earnings (accumulated deficit)	(233,008)	(2,019)
Total stockholders' equity	<u>88,518</u>	<u>334,490</u>
Total liabilities and stockholders' equity	<u>\$ 441,327</u>	<u>\$ 659,873</u>

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



[Table of Contents](#)**iBasis, Inc.****Consolidated Statements of Operations**

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands, except per share data)</b>		
Net revenue from external parties	\$1,097,515	\$741,293	\$605,031
Net revenue from related parties	226,070	197,265	209,158
Total net revenue	<u>\$1,323,585</u>	<u>938,558</u>	<u>814,189</u>
Costs and operating expenses:			
Data communications and telecommunications costs—external parties (excluding depreciation and amortization)	1,081,460	733,160	573,966
Data communications and telecommunications costs—related parties (excluding depreciation and amortization)	105,840	114,242	134,347
Engineering and network operations expenses	23,320	13,222	8,895
Selling, general and administrative expenses	74,849	38,368	29,812
Merger related expenses	—	2,019	—
Depreciation and amortization	31,998	12,743	5,693
Impairment of goodwill	214,651	—	—
Total costs and operating expenses	<u>1,532,118</u>	<u>913,754</u>	<u>752,713</u>
Income (loss) from operations	(208,533)	24,804	61,476
Interest income	2,067	1,680	269
Interest expense	(3,049)	(731)	(32)
Foreign exchange gain (loss)	3,089	(1,101)	(1,339)
Other income	1,779	—	—
Income (loss) before income taxes	(204,647)	24,652	60,374
Income tax expense	26,342	8,529	17,884
Net income (loss)	<u>\$ (230,989)</u>	<u>\$ 16,123</u>	<u>\$ 42,490</u>
Net income (loss) per share:			
Basic	\$ (3.15)	\$ 0.33	\$ 1.06
Diluted	\$ (3.15)	\$ 0.33	\$ 1.06
Weighted average common shares outstanding:			
Basic	73,260	48,778	40,121
Diluted	73,260	49,186	40,121

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

[Table of Contents](#)**iBasis, Inc.****Consolidated Statements of Stockholders' Equity**

	<u>Common Stock</u>		<u>Treasury Stock</u>		<u>Additional Paid-In Capital</u>	<u>Contributed Capital/ Retained Earnings (Accumulated Deficit)</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>
	<u>Number of Shares</u>	<u>\$0.001 Par Value</u>	<u>Number of Shares</u>	<u>Amount</u>				
					(In thousands)			
Balance, December 31, 2005						\$ 8,417	\$ (708)	\$ 7,709
Foreign currency translation adjustments							1,087	1,087
Adoption of FAS 158							520	520
Net income						42,490		42,490
Comprehensive income								44,097
Stock-based compensation						65		65
Net distributions to related parties						(27,893)		(27,893)
Balance, December 31, 2006						23,079	899	23,978
Net income of KPN GCS for the nine months ended September 30, 2007						18,142		18,142
Net distributions to related parties						(27,799)		(27,799)
Stock-based compensation						63		63
Balance, September 30, 2007						13,485	899	14,384
KPN Transaction (see Note 3)	75,641	\$ 76	(1,069)	—	\$332,084	(13,485)		318,675
Exercise of stock options	123				323			323
Exercise of warrants	148				433			433
Stock-based compensation					438			438
Net loss post October 1, 2007						(2,019)		(2,019)
Foreign currency translation adjustments							2,250	2,250
Unrealized gain on short-term marketable securities							6	6
Comprehensive income(1)								18,379
Balance, December 31, 2007	75,912	76	(1,069)	—	333,278	(2,019)	3,155	334,490
Stock repurchases			(3,907)	(15,000)				(15,000)
Exercise of stock options and warrants	292				563			563
Stock-based compensation					2,450			2,450
Related party contribution to equity, net of tax effects					1,299			1,299
Net loss						(230,989)		(230,989)
Foreign currency translation adjustments							(4,295)	(4,295)
Comprehensive loss								(235,284)
Balance, December 31, 2008	76,204	\$ 76	(4,976)	\$(15,000)	\$337,590	\$ (233,008)	\$ (1,140)	\$ 88,518

- (1) Comprehensive income for the year ended December 31, 2007 includes net income of KPN GCS for the nine months ended September 30, 2007 of \$18,142.

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

[Table of Contents](#)**iBasis, Inc.****Consolidated Statements of Cash Flows**

	<b>Years ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>		
Cash flows from operating activities			
Net income (loss)	\$(230,989)	\$ 16,123	\$ 42,490
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Impairment of goodwill	214,651	—	—
Depreciation and amortization	31,998	12,743	5,693
Tax provision related to utilization of pre acquisition net operating losses	16,820	—	—
Stock-based compensation	2,450	501	65
Provision for doubtful accounts receivable	1,622	—	—
Changes in assets and liabilities, excluding the effect of acquisitions:			
Accounts receivable and unbilled revenue—external parties	(31,685)	22,736	36,962
Accounts receivable—related parties	(2,053)	33,807	(25,058)
Prepaid expenses and other current assets	(1,790)	2,944	1,343
Other assets	435	(462)	—
Accounts payable—external parties	20,616	(32,206)	(43,627)
Accounts payable—related parties	(5,798)	(926)	—
Deferred revenue	2,391	172	—
Accrued expenses	15,105	3,475	14,682
Deferred income taxes	(408)	(614)	—
Other long-term liabilities	(318)	(207)	—
Net cash provided by operating activities	<u>33,047</u>	<u>58,086</u>	<u>32,550</u>
Cash flows from investing activities:			
Cash and cash equivalents of iBasis on October 1, 2007 acquired in KPN Transaction	—	54,711	—
Purchases of property and equipment	(15,955)	(9,605)	(3,854)
Purchase of certain assets from TDC	(11,050)	—	—
Maturities of available-for-sale short-term marketable investments	1,999	1,994	—
Increase (decrease) in other long-term assets	5,000	(5,000)	—
Net cash provided by (used in) investing activities	<u>(20,006)</u>	<u>42,100</u>	<u>(3,854)</u>
Cash flows from financing activities:			
Purchases of common stock	(15,000)	—	—
Partial payment of working capital loan to related party	(4,742)	—	—
Payment from KPN related to KPN Transaction	—	55,000	—
Dividend payment to iBasis shareholders	—	(113,000)	—
Dividend payment related to warrant exercises	(323)	(468)	—
Bank borrowings	5,000	25,000	—
Repayment of bank borrowings	(2,920)	—	—
Payments of principal on capital lease obligations	(1,609)	(369)	—
Net distributions to related party	—	(27,799)	(27,893)
Payments on note payable to affiliate	—	—	(1,016)
Proceeds from exercise of warrants	—	195	—
Proceeds from exercise of common stock options	563	323	—
Net cash used in financing activities	<u>(19,031)</u>	<u>(61,118)</u>	<u>(28,909)</u>
Effect of changes in exchange rates on cash and cash equivalents	<u>(833)</u>	<u>2,256</u>	<u>1,994</u>
Net increase (decrease) in cash and cash equivalents	<u>(6,823)</u>	<u>41,324</u>	<u>1,781</u>
Cash and cash equivalents, beginning of year	63,735	22,411	20,630
Cash and cash equivalents, end of year	<u>\$ 56,912</u>	<u>\$ 63,735</u>	<u>\$ 22,411</u>
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	\$ 2,604	\$ 731	\$ 32
Cash paid during the year for income taxes	\$ 20,549	\$ 14,608	\$ 281
Supplemental disclosure of non-cash investing and financing activities:			
Shares issued in KPN Transaction	\$ —	\$ 376,675	\$ —
Exercise of warrants on a net basis	\$ 64	\$ 760	\$ —
Purchases of property and equipment under capital leases	\$ 1,731	\$ —	\$ —
Related party contribution to equity	\$ 1,299	\$ —	\$ —

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

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements**

**(1) Business**

***Business***

We are a leading wholesale carrier of international long distance telephone calls and a provider of retail prepaid calling services and enhanced services for mobile operators.

Our operations consist of our wholesale trading business ("Trading"), in which we connect buyers and sellers of international telecommunications services, and our retail services business ("Retail"). Our Trading business also includes Outsourcing revenue which we generate as the exclusive provider of wholesale international voice services for specific carrier customers.

In the Trading business we receive voice traffic from buyers—originating telecommunications carriers who are interconnected to our network via Voice over Internet Protocol ("VoIP") or traditional time division multiplexing ("TDM") connections, and we route that traffic over our network to sellers—local service providers and telecommunications carriers in the destination countries with whom we have established agreements to manage the completion or termination of calls. We offer our Trading service on a wholesale basis to carriers, mobile operators, consumer VoIP companies, telephony resellers and other service providers worldwide. Our Outsourcing revenue currently consists of international voice traffic we terminate for Royal KPN and its affiliates (KPN Mobile, E-Plus and Base) and for TDC, the leading telecommunications carrier in Denmark.

As a result of the combination with KPN GCS in October 2007 (described below), more than half of our traffic utilizes our VoIP network, while the balance is carried over our TDM network. The continued migration of the TDM traffic to our lower cost VoIP network is expected to be a significant source of synergies from the KPN transaction over the next several years.

Our Retail business consists of retail prepaid calling cards, which are marketed through distributors primarily to ethnic communities within major metropolitan markets in the United States, and Pingo®, a prepaid calling service that we offer and sell directly to consumers via an eCommerce model. Both can be private-labeled for other service providers. The prepaid calling card business and Pingo leverage our existing international network and have the potential to deliver higher margins than are typically achieved in the wholesale Trading business. In addition, the retail prepaid calling card business typically has a faster cash collection cycle than the wholesale Trading business. In 2007 we launched PingoBusiness, enhancements that enable businesses to manage multiple Pingo accounts through a single administrative account.

We use proprietary, patented and patent-pending technology in our global VoIP network to automate the selection of routes and termination partners based on a variety of performance, quality, and business metrics. We have call termination agreements with local service providers in more than 100 countries in North America, Europe, Asia, the Middle East, Latin America, Africa and Australia.

***KPN Transaction***

On October 1, 2007, iBasis, Inc. and KPN B.V. ("KPN"), a subsidiary of Royal KPN N.V. ("Royal KPN"), completed transactions ("KPN Transaction") pursuant to which iBasis issued 40,121,074 shares of its common stock to KPN and acquired the outstanding shares of two subsidiaries of KPN ("KPN GCS"), which encompassed KPN's international wholesale voice business. The Company also received \$55 million in cash from KPN, subject to post-closing adjustments based on the working capital and debt of iBasis and KPN GCS. Immediately after issuance on October 1, 2007, the shares of iBasis

[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(1) Business (Continued)**

common stock issued to KPN represented 51% of the issued and outstanding shares of iBasis common stock on a fully-diluted basis (which included all of the issued and outstanding common stock and the common stock underlying outstanding "in-the-money" stock options, as adjusted, and warrants to purchase common stock).

On October 8, 2007, iBasis paid a dividend in the amount of \$113 million at a rate of \$3.28 per share to each of its shareholders on the record date of September 28, 2007, the trading date immediately prior to the closing date of the KPN Transaction. In addition, holders of outstanding warrants to purchase our common stock will be entitled to receive a cash payment upon the future exercise of these warrants equal to the dividend amount that would have been payable if the warrants had been exercised immediately prior to the record date of the dividend. As of December 31, 2008, we have unexercised warrants representing 432,000 shares, at exercise prices ranging from \$6.30 to \$9.00 per share, and have \$1.4 million accrued for dividends to be paid upon the potential future exercise of these warrants. In connection with the payment of the dividend to shareholders, we also increased the number of shares subject to unexercised stock options and decreased the exercise price of these stock option grants to preserve their value.

The officers of iBasis immediately prior to the closing of the KPN Transaction have continued to serve as the officers of the combined company and one executive of KPN GCS, Mr. Edwin Van Ierland, was appointed as the Company's Senior Vice President Worldwide Sales. Upon closing of the KPN Transaction, Messrs. Charles Skibo and David Lee, two independent members of iBasis' board of directors, resigned as members of the board of directors and the board of directors of iBasis appointed Messrs. Eelco Blok and Joost Farwerck, two executives of Royal KPN N.V., as directors to fill the vacancies created by the resignations of Messrs. Skibo and Lee.

Although iBasis acquired all of the outstanding capital stock of KPN GCS, after the closing of the transaction, KPN holds a majority of the outstanding common stock of iBasis and KPN's designees are expected to represent, at a future date, a majority of the Company's board of directors. Accordingly, for accounting and financial statement purposes, the KPN Transaction has been treated as a reverse acquisition of iBasis by KPN GCS under the purchase method of accounting and the financial results of KPN GCS have become the historical financial results of the combined company and replace the historical financial results of iBasis as a stand-alone company. Thus, the financial results reported for the full year 2007 include the results of KPN GCS alone for the first nine months of 2007 and the financial results of the combined company for the fourth quarter of 2007 only.

The presentation of the Statement of Stockholders' Equity reflects the historical stockholders' equity of KPN GCS through September 30, 2007. The effect of the issuance of shares of iBasis common stock to KPN and the inclusion of iBasis' stockholders' equity as a result of the closing of the KPN Transaction on October 1, 2007 is reflected in the year ended December 31, 2007.

Prior to October 1, 2007, KPN GCS operated as an integrated part of KPN since inception and the historical financial statements of KPN GCS have been derived from the accounting records of KPN using the historical basis of assets and liabilities. As a result, KPN GCS did not operate as a stand-alone business and the historical combined financial statements may not necessarily be representative of amounts that would have been reflected in the financial statements presented had KPN GCS operated independently of KPN.

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(1) Business (Continued)**

KPN GCS benefited from certain related party revenue and purchase agreements with KPN that included sales prices per minute and costs per minute. KPN GCS also relied on KPN for a substantial part of its operational and administrative support, for which it was allocated costs primarily consisting of selling, general and administrative expenses, such as costs for centralized research, legal, human resources, payroll, accounting, employee benefits, real estate, insurance, information technology, telecommunications, treasury and other corporate and infrastructure costs. In anticipation of the closing of the transaction with iBasis, KPN GCS entered into a Framework Services Agreement with KPN in 2006, which replaced the revenue and purchase agreements and operational and administrative support arrangements described above.

***TDC Transaction***

On April 1, 2008, we acquired certain assets from TDC, the leading telecommunications carrier in Denmark, as well as certain assets, contracts and four employees of TDC's subsidiary in the U.S., TDC Carrier Services U.S., for approximately \$11 million in cash ("TDC Transaction"). Pursuant to the TDC Transaction, we became the exclusive provider of international voice services for TDC under a five-year strategic outsourcing arrangement, and TDC will be a preferred partner for terminating traffic sent by us into the Nordic region, consisting of Denmark, Finland, Iceland, Norway and Sweden.

Approximately 130 non-Nordic international wholesale voice customers, as well as all of TDC's interconnection and bilateral agreements for inbound and outbound international phone calls have been transferred to us. TDC will retain its Nordic customer base and its pan-Nordic reach.

In connection with the closing of the TDC transaction, we recorded \$10.1 million of intangible assets, primarily wholesale customer relationships. The wholesale customer relationships are being amortized over a 5 to 10 year period using the economic consumption method to reflect the diminishing cash flows from these relationships in the future.

**(2) Summary of Significant Accounting Policies**

***Principles of Consolidation*** The accompanying consolidated financial statements as of and for the year ended December 31, 2008, include the accounts of iBasis, Inc. and its subsidiaries. All intercompany balances and transactions have been eliminated on consolidation. The accompanying consolidated financial statements as of and for the year ended December 31, 2007 include the accounts of KPN GCS for the full year and the accounts of iBasis, Inc. since October 1, 2007. All intercompany balances and transactions between KPN GCS and iBasis since October 1, 2007 have been eliminated in consolidation. The consolidated financial statements for the year ended December 31, 2006 are the combined accounts of KPN GCS, which include KPN Global Carrier Services B.V., a Netherlands company, and KPN INS, Inc., a Delaware corporation, both of which were wholly-owned by KPN prior to October 1, 2007. All significant intercompany balances and transactions within these combined entities have been eliminated. Intercompany balances and transactions with KPN and its other subsidiaries ("related parties" or "affiliates") have not been eliminated, but are presented herein as balances and transactions with related parties.

***Use of Estimates*** The preparation of these financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires us to (i) make judgments, assumptions and estimates that affect the reported amounts of assets, liabilities,

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Summary of Significant Accounting Policies (Continued)**

revenue and expenses; and (ii) disclose contingent assets and liabilities. A critical accounting estimate is an assumption that could have a material effect on our consolidated financial statements if another, also reasonable, amount were used or a change in the estimates is reasonably likely from period to period. We base our accounting estimates on historical experience and other factors that we consider reasonable under the circumstances. However, actual results may differ from these estimates. To the extent there are material differences between our estimates and the actual results, our future financial condition and results of operations will be affected.

**Foreign Currency Translation and Transactions** The functional currency of KPN GCS is the euro. For the purposes of presenting the consolidated financial statements, the functional currency of KPN GCS has been converted into U.S. dollars for balance sheet accounts using the exchange rate in effect on the balance sheet date. Revenue and expenses are translated into U.S. dollars at the weighted average exchange rates in effect during the period. The effect of these translation adjustments are reported within Accumulated Other Comprehensive Income, a component of stockholders' equity. Transactions in foreign currency are recorded at the original rates of exchange in force at the time the transactions are effected. Exchange differences arising on (i) settlement of transactions and (ii) translation of such transactions, given that no settlement has occurred, are recognized in results of operations.

We have, in the past, entered into foreign currency forward contracts to manage foreign currency exposures related to sales to foreign customers. We do not have designated hedges in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "*Accounting for Derivative Instruments and Hedging Activities*", and accordingly, any unrealized gains and losses are recorded in the Consolidated Statements of Operations and in the Consolidated Balance Sheets within Prepaid expenses and other current assets or Accrued expenses and other current liabilities.

**Other Comprehensive Income (Loss)** Other comprehensive income (loss) primarily relates to foreign currency translation adjustments from entities with functional currencies other than the U.S. dollar. Components of other comprehensive income (loss) are included within the Consolidated Statements of Stockholders' Equity.

**Cash and Cash Equivalents** Cash and cash equivalents consist of all highly liquid investments that are readily convertible into cash and have original maturities of three months or less.

**Short-term Marketable Securities** Short-term marketable securities at December 31, 2007 were classified as available-for-sale and carried at fair value and consist of corporate bonds, with original maturities at the date of acquisition ranging from 90 days to one year.

**Accounts Receivable and Unbilled Revenue** Accounts receivable and unbilled revenue are stated at face value, less an allowance for doubtful accounts. Collectibility of accounts receivable is reviewed regularly and is based upon our knowledge of customers and compliance with credit terms. The allowance for doubtful accounts is adjusted based on such evaluation, with a corresponding charge included in selling, general and administrative expense. Accounts receivable and their related allowance balances are written-off when we deem them uncollectible.

**Property and Equipment** Property and equipment are stated at cost less accumulated depreciation and any recognized impairment loss. Additions and improvements that extend the useful life of an asset



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## iBasis, Inc.

## Notes to Consolidated Financial Statements (Continued)

## (2) Summary of Significant Accounting Policies (Continued)

are capitalized; maintenance and repairs are expensed as incurred. When assets are retired or disposed of, the assets and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss, if any, is reflected in the Consolidated Statements of Operations. In accordance with Statement of Position 98-1, *"Accounting for the Costs of Computer Software Developed or Obtained for Internal Use"* ("SOP 98-1"), costs associated developing software for internal use are capitalized when both the preliminary project stage is completed and management has authorized further funding for the project which it deems probable of being completed. Capitalization of such costs ceases no later than the point at which the project is substantially complete and ready for its intended use.

The cost of property and equipment is depreciated using the straight-line method over the following estimated useful lives of the respective assets:

<u>Asset Classification</u>	<u>Estimated Useful Life</u>
Network equipment	3–7 years
Software	3 years
Leasehold improvements	Lesser of Useful Life or Lease Term
Other tangible fixed assets	3–7 years

**Goodwill and Other Intangible Assets** Intangible assets consist of goodwill, which has an indefinite life and is not amortized, and identifiable intangible assets, consisting of trade name and trademarks, customer relationships, termination partner relationships and technology.

Identifiable intangible assets are being amortized using either the straight-line method or economic consumption method over the following estimated useful lives:

<u>Intangible Asset</u>	<u>Amortization Method</u>	<u>Estimated Useful Life</u>
Trade name and trademarks	Straight-line	15 years
Customer relationships	Economic consumption	5–10 years
Termination partner relationships	Economic consumption	5 years
Technology	Straight-line	5 years

**Impairment of Property and Equipment and Intangible Assets** In accordance with SFAS No. 144 ("SFAS No. 144"), *"Accounting for the Impairment or Disposal of Long-Lived Assets"*, we review the value of our property and equipment and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset group to the future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured as the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

**Impairment of Goodwill** SFAS No. 142, *"Goodwill and Other Intangible Assets"* ("SFAS No. 142"), requires goodwill to be tested for impairment on an annual basis and between annual tests when events or circumstances would more likely than not reduce the fair value of a reporting unit below its carrying value. We test our goodwill for impairment annually as of the end of the fiscal year. SFAS No. 142 requires that the impairment test be performed through the application of a two-step process. The first



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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Summary of Significant Accounting Policies (Continued)**

step compares the carrying value of our reporting units, which are our Trading and Retail operating segments, to their estimated fair values as of the test date. If fair value is less than carrying value, a second step must be performed to quantify the amount of the impairment, if any. The amount of any impairment is measured by the excess of the implied fair value of goodwill over its carrying value.

**Revenue Recognition** In accordance with the Securities and Exchange Commission's Staff Accounting Bulletin No. 104, "Revenue Recognition" ("SAB 104"), we recognize revenue when it is realized or realizable and earned. We consider revenue realized or realizable and earned when there is persuasive evidence of an arrangement, delivery has occurred or the service has been provided, the sales price is fixed or determinable and collectibility is reasonably assured.

For our Trading business, traffic fees are charged at an agreed price for a fixed duration of time or capacity and are recognized as revenue based upon usage of our network and facilities. Estimates for incentive rebates, customer disputes and other allowances are recorded as a reduction of revenues in the period the related revenues are recorded. These estimates are based upon contracted terms, historical experience and information currently available to management with respect to business and economic trends. Revisions to these estimates are recorded in the period in which the facts that give rise to the revision become known.

For our Retail business, revenue is deferred upon activation of the prepaid calling cards, or purchase of our web-based calling services, and is recognized as the prepaid balances are reduced based upon minute usage and service charges.

**Concentration of Credit Risk and Significant Customers** Financial instruments that potentially subject us to significant concentrations of credit risk are primarily cash equivalents, short-term marketable securities and accounts receivable. No external customers represented 10% or more of our total accounts receivable or net revenues for the periods presented. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising our customer base and their dispersion across different industries and geographies.

**Fair Value of Financial Instruments** Financial instruments consist principally of cash and cash equivalents, short-term marketable securities, accounts receivable, accounts payable, accrued expenses and long-term debt. The estimated fair value of these instruments approximates their carrying value.

**Stock-based Compensation** We account for equity awards to our employees under the provisions of SFAS No. 123R, "Share-Based Payment," which requires us to record compensation expense based on the fair value of our stock-based compensation awards.

**Income Taxes** We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." This statement requires an asset and liability approach to accounting for income taxes based upon the future expected values of the related assets and liabilities. Deferred income taxes are provided for tax and financial reporting basis differences between assets and liabilities at tax rates expected to be in effect when the basis differences reverse. Valuation allowances are provided in situations where recoverability of deferred tax assets is not considered more likely than not.

**Net Income (Loss) Per Share** Basic and diluted net loss per common share is determined by dividing net loss by the weighted average common shares outstanding during the period. Basic and

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Summary of Significant Accounting Policies (Continued)**

diluted net income per common share is determined by dividing net income by the weighted average common shares and common equivalent shares outstanding during the period. In 2007, as KPN GCS was wholly-owned by KPN prior to October 1, 2007, basic weighted average shares outstanding was based on the 40.1 million shares issued by iBasis to KPN on the closing of the KPN Transaction for the first nine months of 2007, and the total weighted average shares outstanding of the Company of 74.7 million shares for the fourth quarter of 2007. Diluted weighted average shares in 2007 includes the dilutive effect of iBasis outstanding stock options and warrants for the fourth quarter of 2007 only. In 2006, basic and diluted weighted average shares represent the 40.1 million shares issued by iBasis to KPN.

***New Accounting Pronouncements***

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, "*Fair Value Measurements*", ("SFAS No. 157"). SFAS No. 157 establishes a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. This accounting standard is effective for financial statements issued for fiscal years beginning after November 15, 2007. However, in January 2008, the FASB issued FASB Staff Position FAS 157-b, "*Effective Date of FASB Statement No. 157*" ("FSP FAS 157-b"). FSP FAS 157-b permits entities to elect to defer the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. We have elected to defer the adoption of SFAS No. 157 for those assets and liabilities included in FSP FAS 157-b. The adoption of SFAS No. 157 did not have a material effect on our financial position, results of operations and cash flows for the year ended December 31, 2008.

On January 1, 2008, we adopted Statement of Financial Accounting Standards (SFAS) No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115*" (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which are not otherwise currently required to be measured at fair value. Under SFAS No. 159, the decision to measure items at fair value is made at specified election dates on an instrument-by-instrument basis and is irrevocable. Entities electing the fair value option are required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. The adoption of SFAS No. 159 did not have a material effect on our financial position, results of operations and cash flows for the year ended December 31, 2008.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ("SFAS No. 141R"), "*Business Combinations*" and SFAS No. 160 ("SFAS No. 160"), "*Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51.*" SFAS No. 141R will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS No. 141R and SFAS No. 160 are effective beginning the first fiscal quarter of 2009. Early adoption is not permitted. SFAS No. 141R may give rise to more volatility in our results of operations for future acquisitions.

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(2) Summary of Significant Accounting Policies (Continued)**

In March 2008, the FASB issued SFAS No. 161 ("SFAS No. 161"), *"Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133."* The standard is intended to enhance the current disclosure framework in Statement 133, Accounting for Derivative Instruments and Hedging Activities. The standard requires that objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. We do not expect the adoption of SFAS No. 161 will have a material effect on our financial position, results of operations and cash flows.

In April 2008, the FASB issued FASB Staff Position No. FAS 142-3, *"Determination of the Useful Life of Intangible Assets"* ("FSP 142-3"). FSP 142-3 is effective for financial statement issued for fiscal years beginning after December 15, 2008 and interim period within those years. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset, under SFAS No. 142, *"Goodwill and Other Intangible Assets"* ("SFAS No. 142"). FSP 142-3 is intended to improve the consistency between the useful life of an intangible asset determined under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141R and other generally accepted accounting principles. We do not expect the adoption of FSP 142-3 to have a material effect on our financial position, results of operations and cash flows.

In May 2008, the FASB issued SFAS ("SFAS No. 162"), *"The Hierarchy of Generally Accepted Accounting Principles."* SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles. SFAS No. 162 becomes effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *"The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles."* We do not expect that the adoption of SFAS No. 162 to have a material effect on our financial position, results of operations and cash flows.

**(3) Purchase Accounting for KPN Transaction**

Under the purchase method of accounting, the purchase price for the KPN Transaction was allocated to the tangible and identifiable intangible assets and liabilities of iBasis on the basis of their fair values on October 1, 2007, the closing date of the transaction. As KPN GCS was not a publicly traded entity, the purchase price for this transaction was based, in part, on the fair market value of iBasis' common stock. The market price used to value iBasis' shares of \$10.75 was the closing price of the stock on September 28, 2007, the business day immediately prior to the closing of the KPN Transaction.

[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(3) Purchase Accounting for KPN Transaction (Continued)**

The total purchase price for this transaction consisted of the following:

	<u>(In thousands)</u>
iBasis outstanding shares on October 1, 2007 of 34,451 at \$10.75 per share	\$ 370,353
Fair value of outstanding vested and unvested stock options, less unearned compensation	13,425
Fair value of outstanding warrants to purchase common shares	4,624
Direct acquisition costs	2,453
Dividend to iBasis shareholders paid from existing iBasis cash and short-term marketable securities	(58,000)
Accrued dividend payable for outstanding warrants to purchase common shares	(2,468)
Amount payable to KPN for iBasis working capital adjustment	(11,577)
Accrued severance	(135)
Total purchase price	<u>\$ 318,675</u>

In determining the fair value of iBasis' identifiable assets and liabilities as of October 1, 2007, we recorded \$97.7 million of amortizing intangible assets, including trade names and trademarks, customer relationships, termination partner relationships, and technology. The estimated useful life of trade names and trademarks is 15 years and is being amortized on a straight-line basis. The estimated useful life of customer relationships is 10 years for wholesale customers and 5 years for retail distributor relationships and these intangible assets are being amortized using an economic consumption method to reflect diminishing cash flows from these relationships in the future. The estimated useful life of termination partner relationships is 5 years and is being amortized using an economic consumption method. The estimated useful life of technology is 5 years and is being amortized on a straight-line basis.

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(3) Purchase Accounting for KPN Transaction (Continued)**

The allocation of the purchase price to the fair values of iBasis' assets and liabilities on October 1, 2007, which resulted in the recording of \$248.8 million in goodwill, was as follows:

	<u>(In thousands)</u>
Current assets	\$ 128,875
Property and equipment	23,258
Other assets	520
Trade names and trademarks	21,800
Customer relationships	34,200
Termination partner relationships	8,400
Technology	33,300
Total assets	<u>250,353</u>
Deferred revenue	11,331
Dividend payable	60,468
Other current liabilities	103,469
Deferred tax liabilities, long term	3,556
Other non-current liabilities	1,649
Total liabilities	<u>180,473</u>
Net assets	69,880
Goodwill	248,795
Total purchase price	<u><u>\$ 318,675</u></u>

The total \$248.8 million of goodwill has been assigned to the Company's wholesale Trading reporting unit. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill is not being amortized. In the fourth quarter of 2008, the Company determined that the carrying value of goodwill was impaired. As a result, the Company recorded a charge for the impairment of goodwill in the amount of \$214.7 million. As a result of this impairment charge and a further reduction to the carrying value of \$16.8 million for the utilization of previously reserved pre-acquisition net operating losses, the carrying value of goodwill has been reduced to \$17.3 million as of December 31, 2008. See further discussion of the goodwill impairment charge recorded in 2008 in Note 8 to the Consolidated Financial Statements.

**Working Capital and Debt Adjustments**

In accordance with the Share Purchase Agreement for the KPN Transaction, a post-closing adjustment was required if (i) iBasis' working capital was lower than or exceeded \$37,100,000; (ii) iBasis' debt exceeded or was lower than \$2,900,000; (iii) the combined working capital of KPN GCS was lower than or exceeded (\$6,100,000); and/or (iv) the combined debt of KPN GCS exceeded \$0, as of the date of the closing of the KPN Transaction. Based on iBasis' balance sheet position on the date of the closing of the KPN Transaction, working capital was \$13,353,000 less than the specified level of \$37,100,000, and debt was \$1,776,000 less than the specified level of \$2,900,000. As a result, a payment of \$11,577,000 was due to KPN from iBasis. Based on KPN GCS's balance sheet position on the date of the closing of the KPN Transaction, working capital exceeded the specified level of (\$6,100,000) by

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(3) Purchase Accounting for KPN Transaction (Continued)**

\$3,945,000 and debt was at the specified level of \$0. As a result, payment of \$3,945,000 was due to KPN from iBasis.

In 2008, KPN forgave \$0.8 million in expenses incurred by KPN GCS since the closing of the KPN Transaction. As a result, the amount due to KPN has been reduced by this amount and was recorded as a contribution to equity. These expenses have been recorded in our results of operations. The total amount of \$14.7 million due to KPN was scheduled to be paid by iBasis in three successive quarterly installments through the third quarter of 2008, with interest at the rate of 6% per annum. In May 2008, we made the first payment of \$5.2 million, including interest, to KPN. In September 2008, we revised the terms of the remaining balance of \$10.3 million due to KPN to extend the payment date on the second installment payment to March 2009 and the final installment to June 2009. In addition, the interest rate was increased to 7% on the principal amount due, effective October 1, 2008, and we paid additional interest of \$60,000 relating to the extension of the second installment that was due June 30, 2008.

As of December 31, 2008 and 2007, unpaid principal and accrued interest due to KPN was \$10.5 million and \$15.5 million, respectively.

***Pro Forma Disclosures (Unaudited)***

The following unaudited pro forma consolidated results of operations for the years ended December 31, 2007 and 2006 assumes that the KPN Transaction occurred as of the beginning of each year.

	Year Ended December 31, 2007	Year Ended December 31, 2006
	(In thousands, except per share data)	
Total net revenue	\$1,390,580	\$1,296,651
Total costs and expenses	1,379,654	1,271,625
Income from operations	10,926	25,026
Net income	\$ 3,854	\$ 14,331
Basic net income per share	\$ 0.05	\$ 0.20
Diluted net income per share	\$ 0.05	\$ 0.19

These pro forma amounts do not purport to be indicative of the results that would have actually been obtained if the transaction had occurred as of the beginning of the period presented or that may be obtained in the future.

**(4) Stock Based Compensation**

We issue stock options as an equity incentive to employees and outside directors under our 2007 Stock Plan (the "2007 Plan"). The stock options we issue under our 2007 Plan are for a fixed number of shares with an exercise price equal to the fair market value of our stock on the date of grant. The employee stock option grants under the 2007 Plan typically vest quarterly in equal installments over four years, provided that no options shall vest during the employees' first year of employment, and have a term of ten years.

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(4) Stock Based Compensation (Continued)**

The 2007 Stock Plan replaced the 1997 Stock Incentive Plan, which expired on August 11, 2007. All outstanding stock options under this plan will remain in effect until they expire by their terms.

As of the date of the closing of the KPN Transaction, we had 2.4 million shares of vested and unvested outstanding stock options, almost all of which had been granted under a prior stock option plan, and these outstanding stock options were fair valued as of that date. The aggregate fair value of \$4.0 million relating to 0.6 million shares of unvested stock options as of that date is being charged to results of operations on a straight-line basis over the remaining vesting period for these stock options. The fair value of these outstanding unvested stock options, as of the date of the KPN Transaction and of newly issued grants since that date, was estimated using the Black-Scholes model and the following assumptions:

	Year Ended December 31,	
	2008	2007
Risk free interest rate	2.89%	4.88%
Dividend yield	0.0%	0.0%
Expected volatility	100%	60%–100%
Expected life	6.25 years	2.38 to 6.25 years

Our estimate of the expected life was determined using the simplified method as our stock options qualify as "plain vanilla" options.

Stock-based compensation expense charged to engineering and network operations expenses and selling, general and administrative expenses related to these stock options was \$1.8 million and \$0.7 million, respectively, for 2008, and \$0.1 million and \$0.3 million, respectively, for 2007.

***Dividend-Related Adjustment to Stock Options***

Upon closing of the KPN Transaction, and in conjunction with the \$113 million dividend we paid to iBasis shareholders on October 8, 2007, we increased the number of shares subject to unexercised stock option grants and reduced the exercise price of these stock option grants to preserve their value, as required by the anti-dilution provision of our stock option plan. The adjustment to the number of shares and exercise price was based on the closing price of \$10.75 per share of iBasis common stock on September 28, 2007, the trading date immediately preceding the closing of the merger, reduced by the dividend per share amount of \$3.28 per share. Shares underlying outstanding stock options were increased by a factor of 1.4391, which reflected the ratio of \$10.75 per share divided by \$7.47 per share (\$10.75 per share less the dividend of \$3.28 per share) and the per share exercise price of outstanding stock options was reduced by dividing the exercise price by this same factor. As a result, the number of shares underlying outstanding stock options, as of the date of this adjustment, increased from 2.4 million shares to 3.5 million shares and the average exercise price of outstanding stock options was reduced from \$6.07 per share to \$4.22 per share.

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(4) Stock Based Compensation (Continued)**
**Stock Option Activity**

The following table presents the stock option activity for year ended December 31, 2008:

	Shares (In thousands)	Weighted Average Exercise Price
Outstanding at December 31, 2007	3,426	\$ 4.30
Granted	1,337	4.46
Exercised	(233)	2.42
Cancelled	(284)	5.94
Outstanding at December 31, 2008	4,246	\$ 4.34
Vested and unvested expected to vest at December 31, 2008	3,971	\$ 4.32
Exercisable at December 31, 2008	2,793	\$ 4.10
Available for future grants at December 31, 2008	2,384	

The following table presents weighted average price and contract life information about significant option groups outstanding and exercisable as of December 31, 2008:

Range of Exercise Prices	Outstanding			Exercisable	
	Outstanding Options (In thousands)	Weighted Average Contractual Life Remaining (in Years)	Weighted Average Exercise Price	Options Outstanding (In thousands)	Weighted Average Exercise Price
\$ 0.52–\$ 1.50	265	2.92	\$ 1.44	265	\$ 1.44
1.83– 2.21	391	4.69	2.01	384	2.01
2.44– 3.98	839	5.03	2.94	778	2.88
4.25– 4.54	1,915	8.28	4.51	791	4.50
4.71– 5.87	263	6.67	5.13	247	5.09
6.02– 6.88	482	7.96	6.55	237	6.63
7.73– 10.42	52	1.20	9.18	52	9.18
\$22.93–\$59.93	39	1.40	30.21	39	30.21
	4,246	6.69	\$ 4.34	2,793	\$ 4.10

The aggregate intrinsic value of exercisable options outstanding as of December 31, 2008, which represents the amount option holders would have received had they exercised their options as of that date, was less than \$0.1 million. The intrinsic value is the difference between our closing stock price on the last trading day of the year ended December 31, 2008 and the stock option exercise price, multiplied by the number of stock option shares.



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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(4) Stock Based Compensation (Continued)**

The following table presents the non-vested shares for the year ended December 31, 2008.

<u>Non-vested Stock Options</u>	<u>Shares</u> (in thousands)	<u>Weighted Average</u> <u>Fair Value</u>
Non-vested at December 31, 2007	868	\$ 5.79
Granted	1,337	3.59
Vested	(689)	4.97
Forfeited	(63)	3.59
Non-vested at December 31, 2008	<u>1,453</u>	\$ 4.23

As of December 31, 2008, unrecognized compensation expense related to the unvested portion of our stock options was \$5.3 million and is expected to be recognized over a weighted-average period of approximately 2.8 years.

***Stock Options Grants Under KPN Option Plans***

Prior to the KPN Transaction, certain employees of KPN GCS were provided with stock options for KPN stock under the terms of KPN' stock option plans. These stock options provided for a fixed number of shares with an exercise price equal to the fair value of KPN' stock on the date of grant, unless otherwise stated, and vest three years from the date of grant. There were no grants made to employees of KPN GCS under KPN' stock option plans in 2007 or 2006.

Effective January 1, 2006, KPN GCS adopted SFAS No. 123(R), "*Share-Based-Payment*" (SFAS 123(R)) using the modified prospective method. As KPN GCS had previously applied the fair value recognition provisions of SFAS 123, the adoption of SFAS 123(R) did not have a material impact on its financial position or results of operations. KPN GCS elected to use the modified prospective transition method as permitted under SFAS 123R and, therefore, did not restate its financial results for the prior periods to reflect the fair value of stock-based compensation awards in such periods. Under this transition method, stock-based compensation expense for the year ended December 31, 2006 included compensation expense for all stock option awards granted prior to, but not yet vested, as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123.

Total share based compensation with respect to these stock option awards amounted to \$9,000, \$36,000 and \$47,000 for the years ended December 31, 2008, 2007 and 2006, respectively and was charged to selling, general and administrative expenses.

All options granted are equity settled options and are forfeited when employees leave for reasons other than retirement, disability or death (except for some personnel plans). All options were granted with exercise prices equal to market value unless otherwise noted below. The profits for options exercisable immediately from any exercise prior to the end of the 3-year vesting period are held in escrow until the shares are vested. The profit will be released to the relevant individuals, provided that the individuals remain employed by us.

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(4) Stock Based Compensation (Continued)**

The following table summarizes stock option activity of our employees under the KPN stock option plans during 2008, 2007 and 2006.

	Shares Under Option	Weighted Average Per Share Exercise Price
Outstanding at December 31, 2007	37,250	\$ 9.62
Options exercised	—	—
Transfer to and from other KPN entities	—	—
Outstanding at December 31, 2008	<u>37,250</u>	<u>\$ 9.62</u>

The following is a summary of outstanding and exercisable stock options held by our employees under the KPN stock option plans as of December 31, 2008:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number of Options	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number of Options	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
5.50–6.00	5,800	—	\$ 8.74	5,800	—	\$ 8.74
6.00–6.50	9,600	1.2	9.50	9,600	1.2	9.50
6.50–7.00	21,850	2.6	9.91	21,850	2.6	9.91
Total	<u>37,250</u>	<u>1.8</u>	<u>\$ 9.62</u>	<u>37,250</u>	<u>1.8</u>	<u>\$ 9.21</u>

The aggregate intrinsic value of options outstanding and exercisable as of December 31, 2008 was \$0.2 million, which represents the amount option holders would have received had they exercised their options as of that date. The intrinsic value is the difference between KPN' closing stock price on the last trading day of 2008 and the stock option exercise price, multiplied by the number of stock option shares. The intrinsic value of options exercised in 2008, 2007 and 2006 was \$0, \$98,000 and \$144,000 respectively. The amount of cash KPN received as a result of options exercised by KPN GCS employees in 2008, 2007 and 2006 was \$0, \$104,000, and \$180,000.

In April 2006, KPN GCS granted 5,100 restricted KPN shares to its management which vest over a three-year period depending on KPN' total shareholder return position ranking relative to a peer group. Once vested the restricted shares have a lock-up period of two years and therefore are not available to be traded from April 2009 through April 2011. The total compensation expense associated with these awards in 2008, 2007 and 2006 was \$0, \$27,000 and \$18,000, respectively and was charged to selling, general and administrative expenses.

**(5) Business Segment and Geographic Information**

During the years ended December 31, 2008 and 2007, we operated in two business segments, Trading and Retail. Our Trading business segment includes revenue from wholesale Trading and Outsourcing. We consider Outsourcing as part of our Trading segment as the products we sell are primarily the same products that we sell to our wholesale Trading customers and Outsourcing and wholesale Trading are managed as one business. Our Retail business consists primarily of our prepaid

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(5) Business Segment and Geographic Information (Continued)**

calling card services and Pingo, our prepaid calling service sold directly to consumers through an Internet website. For the year ended December 31, 2006, we operated in only one business segment, wholesale Trading.

A breakdown of our revenue and gross profit, defined as net revenue less data communications and telecommunications costs, for the years ended December 31, 2008 and 2007 is as follows:

	Year Ended December 31, 2008		Year Ended December 31, 2007	
	Revenue	Gross Profit	Revenue	Gross Profit
Trading	\$ 985.0	\$ 80.6	\$716.1	\$ 46.2
Outsourcing	242.0	42.9	197.3	41.4
Retail	96.6	12.8	25.2	3.6
Total	<u>\$1,323.6</u>	<u>\$ 136.3</u>	<u>\$938.6</u>	<u>\$ 91.2</u>

We use net revenue and gross profit, which is net revenue less data communications and telecommunications costs, as the basis for measuring profit or loss and making decisions on our Trading and Retail businesses. We do not allocate our engineering and network operations expenses, selling, general and administrative expenses, and depreciation and amortization between Trading and Retail.

Operating results, excluding interest income and expense, foreign exchange gains or losses, and income tax expense for our two business segments are as follows:

	Year Ended December 31, 2008		
	Trading	Retail (In thousands)	Total
Net revenue from external parties	\$1,000,964	\$96,551	\$1,097,515
Net revenue from related parties	226,070	—	226,070
Total net revenue	<u>1,227,034</u>	<u>96,551</u>	<u>1,323,585</u>
Data communications and telecommunication costs—external parties	997,735	83,724	1,081,459
Data communications and telecommunication costs—related parties	105,841	—	105,841
Total data communications and telecommunications costs	<u>1,103,576</u>	<u>83,724</u>	<u>1,187,300</u>
Gross profit	<u>\$ 123,458</u>	<u>\$12,827</u>	<u>136,285</u>
Engineering and network operations expenses			23,320
Selling, general and administrative expenses			74,849
Depreciation and amortization			31,998
Impairment of goodwill	214,651	—	214,651
Loss from operations			<u>\$ (208,533)</u>

[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(5) Business Segment and Geographic Information (Continued)**

	<b>Year Ended December 31, 2007</b>		
	<b>Trading</b>	<b>Retail</b>	<b>Total</b>
	<b>(In thousands)</b>		
Net revenue from external parties	\$716,088	\$25,205	\$741,293
Net revenue from related parties	197,265	—	197,265
Total net revenue	913,353	25,205	938,558
Data communications and telecommunication costs—external parties	711,575	21,585	733,160
Data communications and telecommunication costs—related parties	114,242	—	114,242
Total data communications and telecommunications costs	825,817	21,585	847,402
Gross profit	\$ 87,536	\$ 3,620	91,156
Engineering and network operations expenses			13,222
Selling, general and administrative expenses			38,368
Merger related expenses			2,019
Depreciation and amortization			12,743
Income from operations			\$ 24,804

Other than revenue from Royal KPN and its affiliates, no one customer accounted for 10% or more of total net revenue in the years ended December 31, 2008, 2007 or 2006.

Assets relating to our Trading and Retail businesses consist of accounts receivable, net of allowance for doubtful accounts, intangible assets related to customer relationships and goodwill. We do not allocate cash and cash equivalents, short-term marketable investments, prepaid expenses and other current assets, property and equipment, net, other intangible assets and other assets between Trading and Retail.

	<b>As of December 31, 2008</b>		
	<b>Trading</b>	<b>Retail</b>	<b>Total</b>
	<b>(In thousands)</b>		
Segment assets:			
Accounts receivable—external parties	\$224,883	\$10,063	\$234,946
Intangible assets—customer relationships	26,147	10,420	36,567
Goodwill	17,324	—	17,324
	<u>\$268,354</u>	<u>\$20,483</u>	<u>288,837</u>
Non-segment assets			152,490
Total assets			<u>\$441,327</u>

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(5) Business Segment and Geographic Information (Continued)**

A breakdown of total revenue by geographic region, based on where we terminate the traffic we receive from our customers, for the year ended December 31, 2008 is as follows;

	<u>% of Total Net Revenue</u>
Europe	43%
Latin America	28%
Middle East and Africa	19%
Asia Pacific	8%
North America	2%
Total	<u>100%</u>

A breakdown of total net revenue by geographic region for the years ended December 31, 2007 and 2006 is not shown as it was impractical to obtain this information. Essentially all of the Company's long-lived assets are located in the United States.

**(6) Accounts Receivable and Unbilled Revenue—External Parties**

Accounts receivable—external parties, net, consists of the following at December 31:

	<u>2008</u>	<u>2007</u>
	<u>(In thousands)</u>	
Accounts receivable	\$183,763	\$168,498
Unbilled revenue	56,361	49,309
	<u>240,124</u>	<u>217,807</u>
Allowance for doubtful accounts	(5,178)	(12,924)
Total accounts receivable—external parties	<u>\$234,946</u>	<u>\$204,883</u>

The majority of unbilled revenue relates to the previous month's traffic volume for which an invoice has not yet been sent. The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on specific known troubled accounts, historical experience, and other currently available evidence.

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(7) Property and Equipment**

Property and equipment consists of the following at December 31:

	<u>2008</u>	<u>2007</u>
	<u>(In thousands)</u>	
Network equipment	\$ 44,332	\$ 41,861
Software	17,538	8,258
Leasehold improvements	1,629	1,591
Other tangible fixed assets	3,594	3,798
Total at cost	<u>67,093</u>	<u>55,508</u>
Accumulated depreciation	<u>(32,257)</u>	<u>(20,542)</u>
Net book value	<u>\$ 34,836</u>	<u>\$ 34,966</u>

Total depreciation and amortization expense related to property and equipment was \$15.3 million, \$8.8 million and \$5.7 million for the years ended December 31, 2008, 2007 and 2006, respectively.

**(8) Goodwill and Other Intangible Assets**

In conjunction with the closing of the KPN Transaction on October 1, 2007, we recorded \$248.8 million of goodwill, which is not being amortized. Additionally, in connection with the KPN Transaction, we recorded \$97.7 million of amortizing intangible assets, including trademarks and trade names, Trading customer and Retail distributor relationships, termination partner relationships and technology. The estimated useful life of trade mark and trade names is 15 years and is being amortized on a straight-line basis. The estimated useful life of Trading customer relationships is 10 years and the estimated useful life of Retail distributor relationships is 5 years and these intangible assets are being amortized using an economic consumption method to reflect the diminishing cash flows from these relationships in the future. The estimated useful life of termination partner relationships is 5 years and is being amortized using an economic consumption method to reflect diminishing cash flows from these relationships in the future. The estimated useful life of technology is 5 years and is being amortized on a straight-line basis.

In connection with the closing of the TDC transaction on April 1, 2008, we recorded \$10.1 million of intangible assets, primarily Trading customer relationships. The Trading customer relationships are being amortized over a 5 to 10 year period using the economic consumption method to reflect the diminishing cash flows from these relationships in the future.

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(8) Goodwill and Other Intangible Assets (Continued)**

The following table summarizes other intangible assets:

	<u>As of December 31, 2008</u>		<u>As of December 31, 2007</u>	
	<u>At Cost</u>	<u>Accumulated Amortization</u>	<u>At Cost</u>	<u>Accumulated Amortization</u>
	<u>(In thousands)</u>			
Trademarks and trade names	\$ 21,800	\$ (1,817)	\$21,800	\$ (363)
Wholesale customer relationships	30,747	(4,616)	20,700	(663)
Retail distributor relationships	13,500	(3,080)	13,500	(621)
Termination partner relationships	8,400	(2,719)	8,400	(588)
Technology	33,300	(8,325)	33,300	(1,665)
Other	64	(48)	—	—
	<u>\$107,811</u>	<u>\$ (20,605)</u>	<u>97,700</u>	<u>\$ (3,900)</u>

Amortization expense was \$16.7 million and \$3.9 million in 2008 and 2007, respectively. There was no amortization of other intangible assets in 2006. We currently expect to amortize the following remaining amounts of intangible assets as of December 31, 2008 in the fiscal periods as follows:

<u>Year ended December 31,</u>	<u>(In thousands)</u>
2009	\$ 19,366
2010	17,916
2011	16,382
2012	12,517
2013	3,875
Thereafter	17,150
Total	<u>\$ 87,206</u>

**Impairment**

We have two operating segments which are also our reporting units: (1) Trading and (2) Retail. As of December 31, 2008 and 2007, all goodwill was assigned to our Trading reporting unit. The Company performs an annual impairment test of its goodwill as required under the provisions of SFAS 142 on December 31 and whenever events or changes in circumstances would more likely than not reduce the fair value of a reporting unit below its carrying value. In fiscal 2007, the Company performed its annual impairment test for goodwill at the reporting unit level and determined no adjustment to goodwill was necessary. For intangible assets, we assess the carrying value of these assets whenever events or circumstances indicate that the carrying value may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset, or asset group, to the future undiscounted cash flows expected to be generated by the asset, or asset group.

Through September 30, 2008, there were no events or changes in circumstances that indicated the carrying amount of our intangible assets may not be recoverable. However, as a result of the Company's market capitalization remaining below the Company's book value since the first quarter of 2008, we considered this to be an indication that the carrying value of our goodwill may be impaired.

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(8) Goodwill and Other Intangible Assets (Continued)**

Accordingly, we conducted an analysis to determine if there had been an impairment of the carrying value of goodwill of as of September 30, 2008.

SFAS No. 142 requires that the impairment test be performed through the application of a two-step process. The first step compares the carrying value of our reporting units, which are our Trading and Retail operating segments, to their estimated fair values as of the test date. If fair value is less than carrying value, a second step must be performed to quantify the amount of the impairment, if any. We estimated the fair value of our reporting units using an income approach, which estimates fair value based upon future cash flows discounted to their present value. We then reconciled the estimated fair value of our reporting units to our overall market capitalization. Based on the results, we determined our Trading reporting unit's fair value was greater than its carrying value. Assessing the impairment of goodwill requires us to make certain significant assumptions, estimates and judgments, including future revenue, expenses, cash flows, discount rates and implied control premiums. The actual results may differ from these assumptions and estimates and it is possible that such differences could have a material impact on our financial statements. We based the valuation of our Trading reporting unit, in part, on i) our actual historical performance; ii) our estimate of the future performance of our Trading reporting unit and iii) projections developed by an independent analyst. As a result of this analysis, we concluded there had been no impairment of the carrying value of goodwill as of September 30, 2008.

Since September 30, 2008, there has been distress in the global economy and our market capitalization declined significantly in the fourth quarter. As noted above, the Company performed its annual goodwill impairment assessment as of December 31, 2008. This assessment was performed using the same valuation techniques as described above. Step one of this assessment resulted in the carrying value of the Trading reporting unit exceeding its fair value. The second step then determines the implied fair value of goodwill by comparing the fair value of the Trading reporting unit to the aggregate fair value of all the assets and liabilities of the unit. In step two of the impairment analysis, the Company compared the implied fair value of goodwill to its carrying value. We determined the fair value of goodwill was \$34.1 million. The carrying value of goodwill was \$248.8 million. As a result, we recorded a non cash impairment charge to our goodwill of \$214.7 million. In addition, the carrying value of goodwill was further reduced by \$16.8 million, to \$17.3 million, as a result of the utilization of previously reserved pre acquisition net operating losses. The primary reasons for the difference in conclusions that goodwill was not impaired as of September 30, 2008, but was impaired as of December 31, 2008, were the continued decline in the price of our common stock during the quarter ended December 31, 2008, forecasts of future revenues which were lower than the forecasts used in the impairment analysis performed as of September 30, 2008, and lower revenues in the quarter ended December 31, 2008 as compared to the quarter ended September 30, 2008 and compared to the Company's expectations for that quarter. The forecasted revenues and long-term growth rates used in the December 31, 2008 analysis were lower than those used at September 30, 2008 as a result of the macroeconomic conditions and events that transpired in the global markets during the fourth quarter of 2008.

As described above, for intangible assets, we assess the carrying value of these assets whenever events or circumstances indicate that the carrying value may not be recoverable. We determined that the adverse business climate and the significant drop in our market capitalization experienced during the fourth quarter of fiscal 2008 were significant events that indicated that the carrying amount of our intangible assets might not be recoverable. SFAS No. 144 is a two-step test which is required to be



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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(8) Goodwill and Other Intangible Assets (Continued)**

performed prior to assessing the impairment of goodwill. The first step compares the carrying value of the asset, or asset group, to the undiscounted cash flows of the asset, or asset group. If the asset, or asset group's, carrying value exceeds the undiscounted cash flows, step two of the test is required to measure the impairment loss, if any. An asset, or asset group, cannot be impaired below the asset or asset group's fair value.

As required by SFAS No. 144, we performed our assessment at the asset group level which represented the lowest level of cash flows that are largely independent of cash flows of other assets and liabilities. For iBasis, this asset grouping is at the reporting unit level. When performing this test at the reporting unit level, goodwill is included in the carrying value of the asset group. The carrying value of the trading reporting unit, including goodwill (prior to the goodwill impairment charge described above), was greater than the undiscounted cash flows while the retail reporting unit's undiscounted cash flows exceeded the carrying value. For our trading reporting unit, we performed step two of the impairment test and determined there was no impairment of our intangible assets as the fair value of the asset group, excluding goodwill, was greater than the carrying value. The projections and assumptions used in calculating the fair value of the assets were consistent with the projections used in the goodwill impairment test. The Company also reassessed the amortization method and remaining amortization period for the assets, and determined that no changes to the amortization period or method were necessary.

Since December 31, 2008, our market capitalization has continued to decline. As a result, it is reasonably possible that there could be an impairment of our intangible assets and/or our remaining goodwill in the near term and the amounts could be material.

**(9) Accrued Expenses**

Accrued expenses consist of the following at December 31:

	2008	2007
	(In thousands)	
Termination fees and circuit costs	\$136,655	\$109,883
Compensation	3,224	3,644
Dividend payable	1,421	1,744
Accrued other	10,385	21,632
Total accrued expenses	<u>\$151,685</u>	<u>\$136,903</u>

**(10) Income Taxes**

The components of income (loss) before provision for income taxes are as follows for the years ended December 31:

	2008	2007	2006
	(In thousands)		
Domestic	\$(239,265)	\$(13,479)	\$ 430
Foreign	34,618	38,131	59,944
Total	<u>\$(204,647)</u>	<u>\$ 24,652</u>	<u>\$60,374</u>

[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(10) Income Taxes (Continued)**

The components of the provision for income taxes are as follows for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(In thousands)		
Current:			
Federal	\$15,637	\$ 89	\$ 93
State	1,127	18	18
Foreign	9,387	10,114	19,194
Current	<u>26,151</u>	<u>10,221</u>	<u>19,305</u>
Deferred:			
Federal	(208)	16	26
State	205	(612)	3
Foreign	194	(1,096)	(1,450)
Deferred	<u>191</u>	<u>(1,692)</u>	<u>(1,421)</u>
Provision for income taxes	<u>\$26,342</u>	<u>\$ 8,529</u>	<u>\$17,884</u>

In 2008, our income tax provision includes a non-cash expense of \$16.8 million related to the utilization of our previously reserved net operating loss carry-forwards. The use of these pre-acquisition net operating losses can not reduce income tax expense but, instead, must reduce the book value of goodwill. The income tax expense of \$16.8 million does not represent income tax payments we will have to make now, or at any time in the future. Effective January 1, 2009, with the adoption of FAS 141R, such pre-acquisition net operating losses will reduce income tax expense, when utilized or when the valuation allowance for such net operating losses is released.

The effective income tax rate differed from the statutory federal income tax rate due to the following for the years ended December 31:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(In thousands)		
Statutory federal income tax	\$(71,589)	\$ 8,628	\$21,131
State income taxes, there is no federal tax benefit	866	13	20
Goodwill impairment	75,128		
Intercompany dividends	19,423		
Other permanent differences	916	146	
Foreign tax rate differential	(3,296)	(3,578)	(3,267)
Losses not benefited	16,032	3,247	
Tax credits	(13,148)		
Change in valuation allowance	6,010		
Other	(4,000)	73	
Provision for income taxes	<u>\$ 26,342</u>	<u>\$ 8,529</u>	<u>\$17,884</u>

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(10) Income Taxes (Continued)**

Deferred income taxes at December 31, 2008 and 2007 reflect the net tax effects of net operating loss and tax credit carry forwards and temporary differences between the carrying amounts of assets and liabilities for financial statement purposes and the amounts used for tax purposes.

The components of our net deferred tax assets (liabilities) are as follow as of December 31:

	<u>2008</u>	<u>2007</u>
	<u>(In thousands)</u>	
Net operating loss carry forward	\$ 56,316	\$ 76,629
Acquired intangible assets	(34,467)	(40,633)
Depreciation	7,725	2,139
Tax credits	14,232	793
Accruals	(2,754)	(2,486)
Stock compensation	2,111	1,563
Accounts receivables	1,457	769
Capital loss carry forward	2,000	2,000
Net deferred tax assets	<u>46,620</u>	<u>40,774</u>
Less: valuation allowance	<u>(48,124)</u>	<u>(42,114)</u>
	<u>\$ (1,504)</u>	<u>\$ (1,340)</u>

We have recognized a full valuation allowance to offset the net deferred tax assets as our history of losses does not support that it is more likely than not that these assets will be realized.

At December 31, 2008, we have foreign tax and research and experimentation ("R&E") credit carry forwards for federal and state purposes of approximately \$14 million, available to offset future taxable income. The foreign tax credit carry forwards generally expire in 2018. The R&E credit carry forwards generally expire between 2012 and 2028.

As of December 31, 2008, we had available U.S. and state net operating loss carry forwards ("NOLs") of approximately \$146 million. The majority of these NOLs were acquired through the KPN Transaction. The operating loss carry forwards expire between 2009 and 2027. These carry forwards may be used to offset future income taxes payable at the federal and state levels, if any, and are subject to review by the U.S. Internal Revenue Service ("IRS") and various state taxing authorities.

In general, the rules of Section 382 of the Internal Revenue Code ("Code") apply to limit a corporation's ability to utilize existing net operating loss carryovers if the corporation experiences an Ownership Change. An ownership change results from transactions increasing the ownership of certain existing stockholders and, or, new stockholders in the stock of a corporation by more than 50 percentage points during a three year testing period.

During 2007, the Company determined that its NOLs were subject to Section 382 limitations. As a result of several ownership changes, the utilization of our NOLs was subject to annual limitations. The limitation caused approximately \$111 million of the federal NOLs to expire unused and therefore not available to be used by the Company. These expired NOLs were not reflected as deferred tax assets at December 31, 2007.

We have two annual limitation amounts, computed pursuant to IRC Section 382. The first annual limitation for NOLs generated before August 2005 is approximately \$5 million. The second annual



[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(10) Income Taxes (Continued)**

limitation for NOLs generated between August 2005 and September 2007 is approximately \$16 million. Any unused IRC Section 382 annual loss limitation amount may be carried forward to the following year. Those unused limitation losses are then added to the current Code Section 382 annual limitation amount.

We adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" ("FIN 48"), on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes", and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Prior to 2007 we recorded estimated income tax liabilities to the extent they were probable and could be reasonably estimated. The adoption of FIN 48 had no effect on our financial statements at January 1, 2007.

We file U.S. federal, state and foreign income tax returns in jurisdictions with varying statutes of limitations. We are subject to U.S. federal income tax, as well as income tax in multiple state and foreign jurisdictions. As of December 31, 2008, we were subject to examination in the U.S. federal and state tax jurisdictions for the 2005 to 2007 tax years. Although we are no longer generally subject to IRS or state examination for the years prior to 2005, carryforward attributes that were generated prior to 2005 may be adjusted upon examination by the IRS if they either have been or will be used in a future period. We are also subject to examination in significant foreign jurisdictions for the 2004 to 2007 tax years.

The following table summarizes the activity related to our unrecognized tax benefits:

	<u>2008</u>	<u>2007</u>
	<u>(In thousands)</u>	
Balance at January 1 (for 2007 at adoption)	\$476	\$ —
Acquisition of acquired company liability	—	307
Additions or reductions for tax positions related to the current year	64	169
Additions or reductions for tax positions related to prior years	—	—
Decreases relating to settlements with tax authorities	—	—
Reductions in benefits related to lapse of statute of limitations	—	—
Balance at December 31	<u>\$540</u>	<u>\$476</u>

At December 31, 2008, we had approximately \$540,000 of unrecognized tax benefits, all of which will impact the effective tax rate, if recognized. In addition we had \$367,000 of accrued interest and penalties. We do not expect the balance of unrecognized tax benefits to change significantly during the next 12 months. We may distribute the current year's earnings of our non-U.S. operations, however it is our intention to permanently reinvest the prior year's earnings indefinitely. Therefore, we have not provided for taxes on these undistributed earnings. We had approximately \$23 million and \$19 million in undistributed earnings at December 31, 2008 and 2007, respectively, for which taxes were not provided. It is not practicable to estimate the amount of the deferred tax liability on such undistributed earnings.

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(11) Long-Term Debt**

Long-term debt consists of the following as of December 31:

	<u>2008</u>	<u>2007</u>
	<u>(In thousands)</u>	
Bank borrowings	\$27,080	\$25,000
Capital lease obligations	877	755
	<u>27,957</u>	<u>25,755</u>
Less: Current portion	(577)	(755)
Long-term portion	<u>\$27,380</u>	<u>\$25,000</u>

In October 2007, we entered into a Second Amended and Restated Loan and Security Agreement (the "Loan Agreement") with Silicon Valley Bank, which amended and restated a certain Amended and Restated Loan and Security Agreement dated as of December 29, 2003. We entered into the Loan Agreement to obtain funding for working capital purposes and in support of the KPN Transaction. Pursuant to the Loan Agreement, which was subsequently amended as described below, we could borrow up to \$35.0 million from time to time under a secured revolving credit facility for a two-year period. Except as described below, borrowings under the Loan Agreement are on a formula basis, based on eligible domestic and foreign accounts receivable. The Loan Agreement contains quarterly financial covenants, consisting primarily of minimum profitability and minimum liquidity requirements. Interest on borrowings under the Loan Agreement were based, in part, on our quarterly profitability, with the maximum interest rate being the bank's prime rate, plus 0.5%, or LIBOR, plus 2.75%. The Loan Agreement has a quarterly commitment fee of 0.63% on any unused portion of the line of credit and we paid an up-front, one-time facility fee of 0.75%, or \$263,000. The Loan Agreement is also guaranteed by all our domestic wholly-owned subsidiaries and is collateralized by a first priority lien and security interest on our and such guarantor's assets. In addition, we pledged 66.2% of all of our ownership in KPN Global Carrier Services (now known as iBasis Netherlands), a wholly-owned subsidiary based in The Netherlands, as collateral. Pursuant to the terms of the Loan Agreement, we may use the proceeds solely (i) for working capital, (ii) to fund our general business requirements, and (iii) to fund the dividend paid by us in connection with the KPN Transaction.

In April 2008, we modified the Loan Agreement to increase our maximum borrowing availability from \$35.0 million to \$50.0 million. In addition, to reflect our current operating results and financial position, we modified the minimum profitability financial covenant and added a minimum cash flow financial requirement pursuant to a sliding scale that decreases over time, a portion of the additional \$15.0 million in funds is subject to a non-formula borrowing base through February 2009. The modification also permitted us to repurchase up to \$15 million of our common stock under a stock repurchase program approved by our board of directors in April 2008. We paid an up-front, one-time supplemental commitment fee of \$150,000 and an up-front, one-time modification fee of \$75,000.

In September 2008, we modified the financial covenants under the Loan Agreement to reflect our current operating results and financial position as follows:

- i) We reduced the minimum profitability covenant for the quarter ended September 30, 2008;
- ii) We reduced the minimum liquidity covenant for the quarter ended September 30, 2008 through February 2009; and

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(11) Long-Term Debt (Continued)**

- iii) We replaced the minimum cash flow covenant with a requirement to maintain at least \$10 million in combined cash and borrowing availability with Silicon Valley Bank for the quarter ended September 30, 2008 through February 2009, and increasing to \$15 million thereafter.

In addition, the interest rate on borrowings under the Loan Agreement was increased by 1% per annum and we paid an up-front, one-time modification fee of \$125,000. At September 30, 2008, we were in compliance of all of the financial covenants, as modified in September 2008, under the Loan Agreement.

On January 26, 2009, the Company and Silicon Valley Bank modified the Loan Agreement, effective as of December 30, 2008. The modification to the Loan Agreement contains the following amendments, among others:

- i) We decreased the amount available under the Loan Agreement from \$50.0 million to \$35.0 million;
- ii) We extended the maturity date of the Loan Agreement to September 30, 2010;
- iii) We established minimum interest rates payable on amounts drawn under the Loan Agreement, which include an interest rate floor of 4.25% on amounts subject to Silicon Valley Bank's prime rate and an interest rate floor of 2.0% on amounts subject to the LIBOR rate;
- iv) We changed formulas for determining quarterly adjustments to margins applicable to prime rate and LIBOR rate and formula for unused revolving line fee from formulas based on the total funded debt ratio to formulas based on EBITDA (earnings before interest, taxes, depreciation and amortization) minus capital expenditures;
- v) We increased the frequency of certain financial reporting requirements from quarterly to monthly as requested by Silicon Valley Bank;
- vi) We modified the minimum adjusted quick ratio financial covenant to require a minimum adjusted quick ratio of 0.80 to 1.00 for the fiscal quarter ended December 31, 2008 and as of the end of each fiscal quarter thereafter;
- vii) We deleted the minimum consolidated EBITDA financial covenant;
- viii) We added a financial covenant requiring consolidated EBITDA minus capital expenditures to be at least (a) (\$1,000,000) with respect to the fiscal quarters ending December 31, 2008 and March 31, 2009, (b) \$1.00 with respect to the fiscal quarter ending June 30, 2009, (c) \$1,750,000 with respect to the fiscal quarter ending September 30, 2009, and (d) \$3,500,000 with respect to the fiscal quarter ending December 31, 2009 and each fiscal quarter thereafter; and
- ix) We modified the minimum liquidity financial covenant to require a minimum liquidity amount of \$17.5 million measured at the end of each fiscal month through August 31, 2009 and a minimum of \$20 million at the end of each fiscal month thereafter. In addition, we are required to maintain at least 40% of our total cash, cash equivalents and short-term investments with Silicon Valley Bank.

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**iBasis, Inc.**
**Notes to Consolidated Financial Statements (Continued)**
**(11) Long-Term Debt (Continued)**

As of December 31, 2008, we were in violation of our minimum profitability covenant under the Loan Agreement. However, Silicon Valley Bank subsequently waived non-compliance of this covenant in the form of the modification to the Loan Agreement executed on January 26, 2009. In connection with this modification, we paid Silicon Valley Bank a modification fee of \$52,500 and a revolving line renewal fee of \$175,000.

At December 31, 2008 and 2007, we had \$27.1 million and \$25.0 million, respectively, in borrowings outstanding, and had issued outstanding standby letters of credit of \$2.6 million and \$2.9 million, respectively, under the Loan Agreement.

During the year ended December 31, 2008, we purchased certain software licenses for \$1.7 million under a 30-month financing agreement, with payments due on a semi-annual basis through June 2010.

**(12) Accrued Restructuring Costs**

At December 31, 2008, we had accrued restructuring costs of \$1.1 million, which consisted of \$0.5 million remaining in future payment obligations relating to a terminated New York City facility lease and \$0.6 million of costs accrued for future lease obligations for certain vacant leased facilities, net of future sublease payments. Payments of these restructuring costs will be made through February 2011.

A summary of accrued restructuring costs is as follows:

<u>(In thousands)</u>	<u>Future Payment Obligation on Lease Termination</u>	<u>Contractual Lease Obligations Relating to Vacant Facilities</u>	<u>Total</u>
Acquisition of acquired company liability	\$ 771	\$ 1,119	\$1,890
Cash payments	(51)	(132)	(183)
Balance, December 31, 2007	720	987	1,707
Additional accrual	11	133	144
Cash payments	(241)	(509)	(750)
Balance, December 31, 2008	<u>\$ 490</u>	<u>\$ 611</u>	<u>\$1,101</u>
Current portion, included in accrued expenses			\$ 758
Long-term portion, included in other long-term liabilities			343
Total			<u>\$1,101</u>



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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(13) Pensions and Postretirement Plans**

Substantially all employees of KPN GCS are participants in various defined benefit pension plans and defined contribution plans administered and sponsored by Royal KPN. Benefits under the pension plans are based primarily on years of service and employees' compensation. The majority of the pension expenses relate to pension plans in The Netherlands and the United States.

These consolidated financial statements reflect the defined benefit plans on a multi-employer basis in accordance with SFAS No. 87, *"Employers' Accounting for Pensions"*. As such, Royal KPN allocated costs associated with the pension plans to KPN GCS based upon a ratio of weighted pensionable income for service costs and allocates costs associated with other components of pension expense, such as interest costs, amortization of actuarial gains/losses, etc., based on projected benefit obligations relative to the total projected benefit obligation of the plans.

Pension expense allocated to KPN GCS from Royal KPN for its employees participating in Royal KPN pension plans was approximately \$0.5 million, \$0.1 million, and \$0.4 million, for the years ended December 31, 2008, 2007 and 2006, respectively.

Dutch employees of Royal KPN are also eligible for early retirement benefits. This plan is accounted for in accordance with SFAS No. 87 (as amended by FAS 158). The early retirement plan is neither funded nor insured through a third party, but is paid directly by KPN GCS to the early retirement employees. Royal KPN allocated early retirement expenses (service costs, interest costs, prior service costs, and actuarial gains and losses) to KPN GCS based on a ratio of service costs relating to its employees relative to the Royal KPN early retirement costs. Until September 30, 2007, Royal KPN allocated the early retirement provision to KPN GCS based on a ratio of the projected benefit obligation relating to its employees relative to Royal KPN's projected benefit obligation. Early retirement expenses were \$0, \$2,000, and \$62,000 for the years ended December 31, 2008, 2007 and 2006, respectively.

As a result of the closing of the KPN Transaction on October 1, 2007, the liability relating to early retirement obligations is no longer being allocated to us by Royal KPN. Accordingly, there was no obligation for early retirement benefits in our consolidated balance sheet as of December 31, 2008 and 2007.

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(14) Commitments and Contingencies**

***Commitments***

We lease our administrative and operating facilities, which expire at various dates through 2018. The future approximate minimum lease payments under such operating leases as of December 31, 2008 consist of the following:

<u>Year ended December 31,</u>	<u>(in thousands)</u>
2009	\$ 2,784
2010	877
2011	392
2012	277
2013	293
Thereafter	1,517
Total future minimum lease payments	<u>\$ 6,140</u>

At December 31, 2008, we had commitments with certain telecommunications carriers for the termination of minutes for the year ended December 31, 2008 totaling \$20.5 million. As of December 31, 2008, we did not have any other material purchase obligations, or other material long-term commitments reflected on our consolidated balance sheet.

***Litigation***

In addition to litigation that we have initiated or responded to in the ordinary course of business, we are currently party to the following potentially material legal proceedings:

*Class Action Pursuant to 1999 Initial Public Offering*

In 2001, we were served with several class action complaints that were filed in the United States District Court for the Southern District of New York against us and several of our officers, directors, and former officers and directors, as well as against the investment banking firms that underwrote our November 10, 1999 initial public offering of common stock and our March 9, 2000 secondary offering of common stock. The complaints were filed on behalf of a class of persons who purchased our common stock between November 10, 1999 and December 6, 2000.

The complaints are similar to each other and to hundreds of other complaints filed against other issuers and their underwriters, and allege violations of the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), primarily based on the assertion that there was undisclosed compensation received by our underwriters in connection with our public offerings and that there were understandings with customers to make purchases in the aftermarket.

In September 2001, the complaints were consolidated and allege that our prospectuses failed to disclose these arrangements. The consolidated complaint seeks an unspecified amount of monetary damages and other relief. In October 2002, the individual defendants were dismissed from the litigation by stipulation and without prejudice and subject to an agreement to toll the running of time-based defenses. In February 2003, the district court denied our motion to dismiss.

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(14) Commitments and Contingencies (Continued)**

In June 2004, we and the individual defendants, as well as many other issuers named as defendants in the class action proceeding, entered into an agreement-in-principle to settle this matter, and this settlement was presented to the court. The district court granted a preliminary approval of the settlement in February 2005, subject to certain modifications to the proposed bar order, to which plaintiffs and issuers agreed. In August 2005, the district court issued a preliminary order further approving the modifications to the settlement, certifying the settlement classes and scheduled a fairness hearing, after notice to the class. Plaintiffs have continued to pursue their claims against the underwriters. The district court established a procedure whereby six "focus" cases are being pursued initially and has certified a class of purchasers in those cases. The underwriters appealed the certification order in each of the six cases and in December 2006, the United States Court of Appeals for the Second Circuit reversed the certification orders. Motions to dismiss amended complaints filed in the six focus cases have been denied.

We anticipate additional settlement negotiations will occur, but there can be no assurance that those negotiations will result in a revised settlement. We believe that if this matter is not settled, we have meritorious defenses which we intend to vigorously assert.

We cannot estimate potential losses, if any, from these matters or whether, in light of our insurance coverage, any loss would be material to our financial condition, results of operations or cash flows. As such, no amounts have been accrued as of December 31, 2008.

*SEC Option Investigation*

We announced on October 20, 2006, that we were contacted by the SEC as part of an informal inquiry and we further disclosed on March 29, 2007, on our Current Report on Form 8-K, that the SEC had notified us that we would be receiving a formal order of investigation relating to our stock option practices. On April 13, 2007, we received the formal order of investigation. The SEC investigation sought documents and information from us relating to the grant of our options from 1999 through 2006. The SEC has taken testimony from individuals including certain of our current and former officers and directors. We have cooperated fully with the SEC investigation and we are in communication with the SEC staff regarding the outcome of the investigation. There is no assurance that we will be able to resolve the SEC investigation on acceptable terms without the institution of enforcement proceedings by the SEC against us or one or more of our senior executive officers or that other inquiries will not be commenced by other U.S. federal, state or other regulatory agencies. An SEC enforcement proceeding could seek an injunction against future violations of the securities laws, a civil penalty and, as to individual executives, disgorgement and a bar order against serving as an officer or director of a publicly traded company. A bar order as to any of our senior executive officers would deprive us of any such executive's services and could have a material adverse affect on our business.

We cannot estimate the amount of losses, if any, from the SEC investigation, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amounts have been accrued as of December 31, 2008.

*Sub-Distributor Action*

On September 20, 2007, J & J Communications ("J & J"), a sub-distributor of calling cards distributed through iBasis distributor Abdul Communications ("Abdul"), amended a complaint filed in the United States District Court for the District of Maryland against Abdul, to add iBasis and PCI, a

[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(14) Commitments and Contingencies (Continued)**

wholesale calling-card provider ("PCI"), as defendants in the matter. The complaint asserts that J & J has lost and continues to lose money because iBasis and PCI deactivated calling cards for which J & J allegedly paid. J & J is seeking in excess of \$1.0 million dollars, plus punitive damages, attorneys fees and litigation costs based on a variety of claims against Abdul, iBasis, and PCI, predicated on contractual theories, various torts, conspiracy and an alleged violation of § 201 of the Telecommunications Act. With respect to iBasis, J & J alleges both direct liability and vicarious liability, for its alleged status as principal in an alleged agency relationship with Abdul. iBasis responded to the amended complaint through an answer and motion to dismiss on February 8, 2008. On June 2, 2008, the Court dismissed the conspiracy and Telecommunications Act claims. Discovery is proceeding as to the remaining claims.

We cannot estimate the amount of losses, if any, from this matter, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amount has been accrued as of December 31, 2008.

*Bankruptcy Preference Claim*

On April 24, 2001 (the "Petition Date"), World Access, Inc. ("World Access"), WorldxChange Communications, Inc. ("WorldxChange"), and Facicom International, LLC ("Facicom"), together with other related debtors (collectively, the "Debtors"), filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Northern District of Illinois (Eastern Division). The Debtors' cases are jointly administered but have not been substantively consolidated. Prior to the Petition Date, we and the Debtors engaged in a reciprocal business relationship. On or about April 21, 2003 the Debtors initiated a large number of avoidance actions, including an adversary proceeding in which the Debtors asserted claims against us for allegedly preferential transfers and nonpayment of overdue amounts owed by iBasis to the Debtors totaling approximately \$2.1 million. We have asserted defenses to the claims, invoked statutory defenses and filed proofs of claim for approximately \$0.5 million to which the trustee for the Debtors has objected. We expect to engage in a mediation to attempt to resolve these claims during the first quarter of 2009 and have determined that it is probable that we will incur a liability of approximately \$0.5 million and, accordingly, we have accrued that amount as of December 31, 2008.

*Consumer Class Action*

We were named in a putative consumer class action complaint, filed in the United States District Court for the District of New Jersey. We were served on May 27, 2008. The putative class action plaintiff, Orlando Ramirez, asserted violations of consumer protection statutes in New Jersey and other states on behalf of an asserted nationwide class of purchasers due to an alleged failure to adequately disclose the actual calling time available on iBasis' prepaid calling cards. We filed a motion to change venue to the Eastern District of New York where named plaintiff resides and purchased the card. Plaintiffs were granted a voluntary dismissal, without prejudice, on July 9, 2008. On December 19, 2008, a substantially similar complaint was filed against us on behalf of Mr. Ramirez in the United States District Court for the Eastern District of New York. As of March , 2009, we have not been served with this complaint. We believe that we have substantial defenses to the claims alleged in the complaint and, if served, we intend to vigorously defend against the claims asserted. We cannot estimate the amount of losses, if any, from this matter, or whether any loss would be material to our financial

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(14) Commitments and Contingencies (Continued)**

condition, results of operations or cash flows. As such, no amount has been accrued as of December 31, 2008.

*Other Matters*

We are also subject to suits for collection, related commercial disputes, claims by former employees, claims related to certain taxes, claims from carriers and foreign service partners over reconciliation of payments for circuits, Internet bandwidth and/or access to the public switched telephone network, and claims from estates of bankrupt companies alleging that we received preferential payments from such companies prior to their bankruptcy filings. We cannot estimate the amount of losses, if any, from these matters, or whether any loss would be material to our financial condition, results of operations or cash flows. As such, no amount has been accrued as of December 31, 2008.

**(15) Related Party Transactions**

***Framework Services Agreement***

As required by and in anticipation of the closing of the KPN Transaction, KPN GCS entered into a Framework Services Agreement with KPN in June 2006. Under these agreements, revenues earned and costs incurred from KPN changed to primarily reflect market prices.

Pursuant to the Framework Services Agreement:

- KPN appointed KPN GCS as a preferred supplier of mobile services for KPN and all their affiliates and subsidiaries; and
- KPN appointed KPN GCS as its exclusive provider for international direct dialing, ISDN and Inmarsat services for all international telephone and fax traffic originating from or carried over KPN's fixed networks.

The Framework Services Agreement has a ten-year term, which is automatically extended for subsequent one-year periods unless either party provides at least three months written notice prior to the end of the then current term. The Framework Services Agreement includes:

- A Service Agreement for International Direct Dial Services and ISDN Services: KPN GCS provides international direct dialing, ISDN and Inmarsat services for international telephone and fax traffic over KPN's fixed network at a price equal to the expected cost of providing services which is determined in advance of the period plus a margin as set forth in the agreement at declining rates through the year 2010. Thereafter, margins shall be negotiated each year.
- A Service Agreement for Management Fee for Shared Services: KPN GCS and KPN will share the following: financial services, human resources, legal services, IT systems, office space, insurance premiums, and administrative and professional support services.
- A Service Agreement for Transmission Path Services: The parties agreed upon certain measurable performance parameters for specific activities relating to various transmission path services that KPN provides to KPN GCS. In addition, the parties also agreed to certain specified service deliverables that KPN GCS is to provide as a system provider and service provider to KPN.



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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(15) Related Party Transactions (Continued)**

- A Service Agreement for IT System Support and Maintenance: The parties agreed upon certain measurable performance parameters for the support and maintenance services that KPN provides to certain information technology ("IT") systems of KPN GCS, including: service provisioning, IT architecture, pricing arrangements for IT maintenance and support, key performance indicators, operational procedures for user incidents, settlement and reporting procedures and other detailed operational IT maintenance and support related specifications.
- A Service Agreement for National Transmission Backbone: The parties agreed upon certain performance, financial, and reporting parameters for KPN's delivery and maintenance of backbone transmission capacity between the international domain and the national domain for KPN GCS.
- A Service Agreement for Support and Maintenance for Technical Infrastructure: The parties agreed upon certain performance, reporting, and financial parameters relating to maintenance and support of the technical infrastructure that KPN provides to KPN GCS. These maintenance and support activities include: capacity management, innovation, delivery of signaling services, and network maintenance.

Prior to the Framework Services Agreement, KPN GCS entered into agreements with KPN and its affiliates and subsidiaries for the sale of international wholesale minutes and the provision of corporate administrative services. The agreements for the sale and purchase of traffic from and to KPN and its affiliates and subsidiaries were made annually and reviewed periodically. These agreements were based on the internal pricing policies of KPN and relevant regulatory requirements. These historical internal pricing policies were not necessarily indicative of the prices KPN GCS would have paid or received had KPN GCS been a stand alone company.

***Intellectual Property Cross-Licenses***

In connection with the closing of the KPN Transaction, iBasis entered into an Intellectual Property License Agreement with Royal KPN. Pursuant to the agreement, iBasis has been granted a worldwide, non-transferable, and non-exclusive license to use Royal KPN' portfolio of patents and certain other Royal KPN intellectual property, and Royal KPN has been granted a worldwide, non-transferable, and non-exclusive license to use iBasis' portfolio of patents.

***Revenue and Data and Telecommunication Costs***

Revenue from KPN and its subsidiaries amounted to \$226.1 million, \$197.3 million, and \$209.2 million for the years ended December 31, 2008, 2007 and 2006, respectively, and is reported in Net revenue from related parties in the Consolidated Statement of Operations.

Under the Framework Services Agreement that was established in June 2006, there was a reduction in price for the termination of international voice traffic coming from the retail organization of KPN, compared to the prior pricing model in effect. As a result, net revenue from related parties decreased approximately \$31.4 million in the period from June 2006 through December 31, 2006. Costs also decreased as a result of lower prices for national and international transmission (approximately \$0.9 million) and corporate services (approximately \$5.0 million) over the same period due the pricing under the Framework Services Agreement, compared to the prior pricing model in effect. In April 2005, the KPN internal pricing model was adjusted as a result of organizational changes at Royal KPN,

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**iBasis, Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**(15) Related Party Transactions (Continued)**

resulting in an increase in Net revenue from related parties, and a decrease in data and telecommunication costs—related parties.

Data and telecommunication costs purchased from KPN and its subsidiaries amounted to \$105.8 million, \$114.2 million and \$134.3 million for the years ended December 31, 2008, 2007 and 2006, respectively, and is reported in Data and telecommunications costs—related parties in the Consolidated Statement of Operations. These costs relate to services for the procurement and transmission of sending and receiving traffic (provided to KPN GCS by KPN and its subsidiaries). Agreements between KPN GCS and KPN and its subsidiaries for the sale of wholesale international minutes were made at various prices and quantities.

***Allocated expenses***

Historically, KPN GCS relied on KPN for a substantial part of its operational and administrative support, for which it was allocated costs primarily consisting of costs for centralized research, legal, human resources, payroll, accounting, employee benefits, facilities, insurance, information technology, telecommunications, treasury and other corporate and infrastructure costs. These expenses were allocated based on the ratio of KPN GCS revenue, operating expenses, and number of employees compared to comparable revenue, operating expenses, and number of employees of KPN, as appropriate for each cost category. However, these allocated expenses did not necessarily reflect the utilization of services provided to or the benefits received by KPN GCS.

Since the date of the KPN Transaction, as part of our integration process, we have reduced the level of services and support required from KPN for our Netherlands operations. In certain cases, such as audit fees, we are now directly responsible for these costs. As a result of our integration efforts to-date, costs incurred directly from KPN have been substantially reduced from previous periods. To further capture cost savings from our integration efforts, we are restructuring our operations in The Netherlands. We expect that our operations in The Netherlands will become primarily sales and product management, with strategic support from locations outside The Netherlands. As this plan has not yet been finalized, we cannot yet determine the amount of any future restructuring charges we may incur and the timing of such charges. In addition, in the future, we will be further reducing the operational services we purchase from KPN as integration projects are completed.

Engineering and network operations expenses include allocated costs from KPN, which were \$6.2 million, \$8.4 million and \$8.9 million for the years ended December 31, 2008, 2007 and 2006, respectively. The decline in costs in 2008 compared to 2007 reflects less required support from KPN for our TDM network.

Selling, general and administrative expenses include allocated corporate and divisional costs from KPN, which were \$2.5 million, \$13.3 million and \$20.8 million for the years ended December 31, 2008, 2007 and 2006, respectively. The significant decline in costs in 2008 compared to 2007 reflects significantly lower costs for information services and other corporate administrative support.

Prior to the KPN Transaction, there was no allocation of interest expense from KPN as there was no debt specific to KPN GCS.



[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(15) Related Party Transactions (Continued)*****Working Capital and Debt Adjustments related to KPN Transaction***

In accordance with the Share Purchase Agreement for the KPN Transaction, a post-closing adjustment was required if (i) iBasis' working capital was lower than or exceeded \$37,100,000; (ii) iBasis' debt exceeded or was lower than \$2,900,000; (iii) the combined working capital of KPN GCS was lower than or exceeded (\$6,100,000); and/or (iv) the combined debt of KPN GCS exceeded \$0, as of the date of the closing of the KPN Transaction. Based on iBasis' balance sheet position on the date of the closing of the KPN Transaction, working capital was \$13,353,000 less than the specified level of \$37,100,000, and debt was \$1,776,000 less than the specified level of \$2,900,000. As a result, a payment of \$11,577,000 is due to KPN from iBasis. Based on KPN GCS's balance sheet position on the date of the closing of the KPN Transaction, working capital exceeded the specified level of (\$6,100,000) by \$3,945,000 and debt was at the specified level of \$0. As a result, payment of \$3,945,000 is due to KPN from iBasis.

In 2008, KPN forgave \$0.8 million in expenses incurred by KPN GCS since the closing of the KPN Transaction. As a result, the amount due to KPN has been reduced by this amount and was recorded as a contribution to equity. These expenses have been recorded in our results of operations. The total amount of \$14.7 million due to KPN was scheduled to be paid by iBasis in three successive quarterly installments through the third quarter of 2008, with interest at the rate of 6% per annum. In May 2008, we made the first payment of \$5.2 million, including interest, to KPN. In September 2008, we revised the terms of the remaining balance of \$10.3 million due to KPN to extend the payment date on the second installment payment to March 2009 and the final installment to June 2009. In addition, the interest rate was increased to 7% on the principal amount due, effective October 1, 2008, and we paid additional interest of \$60,000 relating to the extension of the second installment that was due June 30, 2008.

As of December 31, 2008 and 2007, unpaid principal and accrued interest due to KPN was \$10.5 million and \$15.5 million, respectively.

***Accounts Payable and Accounts Receivable to Related Parties***

As of December 31, 2008, we had accounts receivable due from KPN and its subsidiaries of \$2.1 million and this amount is reflected in Accounts receivable—related parties on the Consolidated Balance Sheets. This amount is net of \$10.5 million outstanding that is due to KPN, including interest, for the post-closing working capital and debt adjustments of iBasis and KPN GCS. As of December 31, 2007, we had accounts payable to KPN and its subsidiaries of \$11.8 million and this amount is reflected in Accounts payable—related parties on the Consolidated Balance Sheets. This balance included the \$15.5 million due to KPN for the post-closing working capital and debt adjustments of iBasis and KPN GCS.

**(16) Stockholders' Equity*****Authorized Capital Stock***

We have authorized for issuance 170 million shares of common stock, \$0.001 par value per share.

We also have authorized for issuance 15 million shares of preferred stock, \$0.001 par value per share. There are no shares of preferred stock issued or outstanding.

[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(16) Stockholders' Equity (Continued)*****Stock Incentive Plan***

At the Annual Meeting of Shareholders held on September 27, 2007, the shareholders of iBasis, Inc. approved the adoption of the iBasis, Inc. 2007 Stock Plan. The 2007 Stock Plan authorizes the grant of up to 3,500,000 shares of common stock for the issuance of stock options, restricted and unrestricted stock awards and other stock-based awards to employees, consultants and directors of iBasis. Under the terms of the 2007 Stock Plan, the exercise price of options granted shall be determined by the Board of Directors and for incentive stock options shall not be less than fair market value of our common stock on the date of grant. Options vest quarterly in equal installments over four years, provided that no options shall vest during the employees' first year of employment. The expiration date of each stock option shall be determined by the Board of Directors, but shall not exceed 10 years from the date of grant. The 2007 Stock Plan replaces the iBasis, Inc. Amended and Restated 1997 Stock Incentive Plan, which expired on August 11, 2007. Pursuant to the terms of the Amended and Restated 1997 Stock Incentive Plan, all outstanding options under such plan will remain in effect until they expire by their terms.

***Warrants***

At December 31, 2008, we had the following warrants to purchase shares of our common stock outstanding:

	<u>Shares Outstanding</u> (In thousands)	<u>Exercise Price Per Share</u>
Warrant issued for investment banking services in connection with private equity placement of iBasis in September 2004	365	\$ 6.30
Warrant issued for investment banking advisory services for iBasis in 2006	67	9.00
Total warrants outstanding	<u>432</u>	

**(17) Foreign Currency Translation of Historical KPN GCS Financial Statements**

The historical KPN GCS financial statements were denominated in Euros, the reporting currency of KPN GCS. The financial statements were translated into US dollars for inclusion in this Form 10-K.

[Table of Contents](#)**iBasis, Inc.****Notes to Consolidated Financial Statements (Continued)****(18) Summary of Quarterly Information (Unaudited)**

The following table reflects our quarterly results of operations for the years ended December 31, 2008 and 2007.

<u>Year Ended December 31, 2008</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter(1)</u>	<u>Total Year</u>
Total net revenue	\$324,903	\$360,840	\$338,023	\$ 299,819	\$1,323,585
Total costs and operating expenses	323,178	357,310	336,820	514,810	1,532,118
Income (loss) from operations	1,725	3,530	1,203	(214,991)	(208,533)
Net income (loss)	<u>\$ (2,072)</u>	<u>\$ 13</u>	<u>\$ 3,294</u>	<u>\$(232,224)</u>	<u>\$ (230,989)</u>
Basic and diluted net income (loss) per share	<u>\$ (0.03)</u>	<u>\$ 0.00</u>	<u>\$ 0.05</u>	<u>\$ (3.26)</u>	<u>\$ (3.15)</u>

<u>Year Ended December 31, 2007</u>	<u>First Quarter(2)</u>	<u>Second Quarter(2)</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>	<u>Total Year</u>
Total net revenue	\$ 178,550	\$ 193,684	\$ 215,679	\$ 350,645	\$938,558
Total costs and operating expenses	170,867	182,508	210,002	350,377	913,754
Income from operations	7,683	11,176	5,677	268	24,804
Net income (loss)	<u>\$ 5,639</u>	<u>\$ 8,357</u>	<u>\$ 4,146</u>	<u>\$ (2,019)</u>	<u>\$ 16,123</u>
Basic and diluted net income (loss) per share	<u>\$ 0.14</u>	<u>\$ 0.21</u>	<u>\$ 0.10</u>	<u>\$ (0.03)</u>	<u>\$ 0.33</u>

- (1) Total costs and operating expenses includes goodwill impairment charge of \$214.7 million (see Note 8).
- (2) First quarter 2007 costs and operating expenses and income from operations has been revised for \$1.3M of costs that were previously capitalized that should have been expensed. Included in this amount is \$964,000 of costs related to the year ended December 31, 2006 that were corrected in the first quarter of 2007. This adjustment reduced net income by \$1.0 million and basic and diluted net income per share by \$0.02. Second quarter 2007 costs and operating expenses and income from operations has also been revised for \$357,000 of costs that were previously capitalized that should have been expensed. This adjustment reduced net income by \$266,000 and basic and diluted net income per share by \$0.01 per share.

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**Item 9. *Change in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable

**Item 9A. *Controls and Procedures***

**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

**(a) Evaluation of Disclosure Controls and Procedures.**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management's evaluation, our chief executive officer and chief financial officer concluded that, as of December 31, 2008, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

**(b) Management's Annual Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act.

Our management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2008. In making its assessment of internal control over financial reporting, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control—Integrated Framework*. Based on this assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2008 based on the criteria set forth by COSO in *Internal Control—Integrated Framework*.

Our independent registered public accounting firm, PricewaterhouseCoopers LLP, that audited the financial statements included in this annual Report on Form 10-K has issued an attestation report on our internal control over financial reporting as of December 31, 2008, which is included in Item 8 of this annual report on Form 10-K.

**(c) Changes in Internal Control**

There were no changes in our internal control over financial reporting, identified in connection with the evaluation of such internal control that occurred during the fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. *Other Information***

Not applicable

[Table of Contents](#)**PART III****Item 10. *Directors, Executive Officers and Corporate Governance***

Information required by this item is included under the captions "Management and Corporate Governance Matters," "Section 16(a) Beneficial Ownership Reporting Compliance," and "Code of Conduct and Ethics" in the iBasis' Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 11. *Executive Compensation***

The information required by this item is included under the captions "Executive Officer and Director Compensation," "Compensation Discussion and Analysis," "Management and Corporate governance Matters—Compensation Committee Interlocks and Insider Participation," "Compensation Committee Report" in the iBasis' Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by this item is included under the captions "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information" in the iBasis' Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

The information required by this item is included under the captions "Certain Relationships and Related Transactions" and "Management and Corporate Governance Matters" in the iBasis' Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 14. *Principal Accounting Fees and Services***

The information required by this item is included under the caption "Independent Public Accountants" in the iBasis' 2009 Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

[Table of Contents](#)**PART IV****Item 15. Exhibits, Financial Statements and Schedules**

(a) We have filed the following documents as part of this Annual Report on Form 10-K:

**(1) Financial Statements:**

	<u>Page</u>
<b><u>Consolidated Financial Statements:</u></b>	
Reports of Independent Registered Public Accounting Firms	64
<b><u>Financial Statements</u></b>	
<a href="#">Consolidated Balance Sheets as of December 31, 2008 and 2007</a>	<a href="#">66</a>
<a href="#">Consolidated Statements of Operations for the Three Years Ended December 31, 2008, 2007 and 2006</a>	<a href="#">67</a>
<a href="#">Consolidated Statements of Stockholders' Equity for the Three Years Ended December 31, 2008, 2007 and 2006</a>	<a href="#">68</a>
<a href="#">Consolidated Statements of Cash Flows for the Three Years Ended December 31, 2008, 2007 and 2006</a>	<a href="#">69</a>
<a href="#">Notes to Consolidated Financial Statements</a>	<a href="#">70</a>

**(2) Index to Financial Statements Schedules:** All financial statement schedules have been omitted because the required information is included in our consolidated financial statements, or the related notes, or is not applicable.

**(3) Index to Exhibits:**

Exhibit Number	Description
2.1	Share Purchase and Sale Agreement between the Registrant and KPN B.V. (formerly KPN Telecom B.V.), dated as of June 21, 2006 (incorporated by reference from Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed August 9, 2006 (file no. 000-27127)).
2.1.1	Amendment No. 1 to Share Purchase and Sale Agreement between the Registrant and KPN B.V. dated as of December 18, 2006 (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed December 18, 2006 (file no. 000-27127)).
2.1.2	Amendment No. 2 to Share Purchase and Sale Agreement between the Registrant and KPN B.V. dated as of April 27, 2007 (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed April 27, 2007 (file no. 000-27127)).
2.1.3	Amendment No. 3 to Share Purchase and Sale Agreement between the Registrant and KPN B.V. dated as of August 1, 2007 (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed August 7, 2007 (file no. 000-27127)).
3.1	First Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference from Exhibit 4.1 to the Registrant's Registration Statement on Form S-8 filed on December 21, 2007 (file no. 333-148307)).
3.2	Second Amended and Restated By-Laws of the Registrant (incorporated by reference from Exhibit 3.01 to the Registrant's Current Report on Form 8-K filed on October 5, 2007 (file no. 000-27127)).
3.2.1	Amendment No. 1 to the Second Amended and Restated By-Laws of the Registrant (incorporated by reference from Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on November 14, 2007 (file no. 000-27127)).

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Exhibit Number	Description
10.1	Lease, dated January 8, 1999, as amended, between the Registrant and Rodger P. Nordblom and Peter C. Nordblom as Trustees of Northwest Associates under Declaration of Trust dated December 9, 1971 with respect to property located at 20 Second Avenue, Burlington, Massachusetts (incorporated by reference from Exhibit 10.1 to the Registrant's Registration Statement on Form S-1 (file no. 333-85545)).
10.2	Lease, dated as of August 7, 1998, between the Registrant and 111 Eighth Avenue LLC, relating to property located at 111 Eighth Avenue, New York, New York (incorporated by reference from Exhibit 10.3 to the Registrant's Registration Statement on Form S-1 (file no. 333-85545)).
10.3	Lease, dated December 11, 1998 between the Registrant and Downtown Properties L.L.C., with respect to property located at 611 Wilshire Boulevard, Los Angeles, California (incorporated by reference from Exhibit 10.4 to the Registrant's Registration Statement on Form S-1 (file no. 333-85545)).
10.4	Lease, dated October 22, 1999, between the Registrant and Roger P. Nordblom and Peter C. Nordblom, as Trustees of N.W. Building 1 Associates under Declaration of Trust dated November 11, 1984 and filed with the Middlesex South Registry District of the Land Court as Document Number 674807 with respect to property located at 10 Second Avenue, Burlington, Massachusetts (incorporated by reference from Exhibit 10.28 to the Registrant's Registration Statement on Form S-1 (file no. 333-96535)).
10.5	iBasis, Inc. 2007 Stock Plan (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 3, 2007 (file no. 000-27127)).
10.6†	2008 Executive Officer Bonus Plan (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on March 3, 2008 (file no. 000-27127)).
10.7*†	2009 Executive Officer Bonus Plan.
10.8*†	Company 409A Policy.
10.9†	Form of Stock Option Agreement under the iBasis, Inc. 2007 Stock Plan (incorporated by reference from Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on October 3, 2007 (file no. 000-27127)).
10.10†	Employment Agreement between the Registrant and Ofer Gneezy, dated as of August 11, 1997 (incorporated by reference from Exhibit 10.9 to the Registrant's Registration Statement on Form S-1 (file no. 333-85545)).
10.11†	Employment Agreement between the Registrant and Gordon J. VanderBrug, dated as of August 11, 1997. (incorporated by reference from Exhibit 10.10 to the Registrant's Registration Statement on Form S-1 (file no. 333-85545)).
10.12†	Offer Letter and Employment Agreement, between the Registrant and Mark S. Flynn, dated January 30, 2007 (incorporated by reference from Exhibit 10.77 to the Registrant's Quarterly Report on Form 10-Q for the three months ended March 31, 2007 (file no. 000-27127)).
10.13†	Offer Letter between the Registrant and Edwin van Ierland, dated September 11, 2007 (incorporated by reference from Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the three months ended September 30, 2007 (file no. 000-27127)).
10.14†	Offer Letter between the Registrant and Richard Tennant, dated as of September 17, 2001 and Employment Agreement, dated as of September 20, 2001 (incorporated by reference from Exhibit 10.30 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001 (file no. 000-27127)).

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Exhibit Number	Description
10.15†	Offer Letter between the Registrant and Paul Floyd, dated as of April 2, 2001 and Proprietary Information and Inventions Agreement dated April 12, 2001 (incorporated by reference from Exhibit 10.31 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2001 (file no. 000-27127)).
10.16	First Amended and Restated Registration Rights Agreement, dated as of July 12, 1999, among the Registrant and the holders of the capital stock of the Registrant who become parties thereto (incorporated by reference from Exhibit 10.17 to the Registrant's Registration Statement on Form S-1 (file no. 333- 85545)).
10.17	Second Amended and Restated Loan and Security Agreement dated October 2, 2007, between iBasis, Inc. and Silicon Valley Bank (incorporated by reference from Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 9, 2007 (file no. 000-27127)).
10.18	First Loan Modification Agreement dated as of April 28, 2008 between Silicon Valley Bank and iBasis, Inc. (incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed May 2, 2008 (file no. 000-27127)).
10.19	Second Loan Modification Agreement dated as of September 30, 2008 between Silicon Valley Bank and iBasis, Inc. (incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed October 6, 2008 (file no. 000-27127)).
10.20*	Third Loan Modification Agreement dated as of December 30, 2008 between Silicon Valley Bank and iBasis, Inc. and signed on January 26, 2009.
10.21	Form of Common Stock Purchase Warrant issued by the Registrant pursuant to the terms of the Securities Purchase Agreement, dated as of September 24, 2004, by and among the Registrant and the Purchasers (as defined therein) to each of the Purchasers (incorporated by reference from Exhibit 10.3 to the Registrant's Current Report on Form 8-K dated September 24, 2004 (file no. 000-27127)).
10.22	Common Stock Purchase Warrant issued by the Registrant to Tejas Securities Group, Inc. on September 24, 2004. (incorporated by reference from Exhibit 10.70 to the Registrant's Form S-1, filed October 18, 2004 (file no. 333-119796).
10.23	Registration Rights Agreement dated as of October 1, 2007, between iBasis, Inc. and KPN B.V. (incorporated by reference from Exhibit 4.01 to the Registrant's Current Report on Form 8-K, filed October 5, 2007 (file no. 333-27127)).
21.1*	Significant Subsidiaries of the Registrant.
23.1*	Consent of Independent Registered Public Accounting Firm.
23.2*	Consent of Independent Registered Public Accounting Firm.
31.1*	Certificate of iBasis, Inc. Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certificate of iBasis, Inc. Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32‡	Certificate of iBasis, Inc Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

† Indicates management compensatory plan, contract or arrangement.

\* Filed herewith.

‡ Furnished herewith.



[Table of Contents](#)**SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

iBASIS, INC.

March 13, 2009

By: /s/ OFER GNEEZY

Ofer Gneezy  
*President and Chief Executive Officer*

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

<u>Name</u>	<u>Title</u>	<u>Date</u>
<u>/s/ OFER GNEEZY</u> Ofer Gneezy	President and Chief Executive Officer and Director (Principal Executive Officer)	March 13, 2009
<u>/s/ GORDON VANDERBRUG</u> Gordon J. VanderBrug	Executive Vice President and Director	March 13, 2009
<u>/s/ RICHARD TENNANT</u> Richard G. Tennant	Senior Vice President, Finance and Chief Financial Officer (Principal Financial and Accounting Officer)	March 13, 2009
<u>/s/ EELCO BLOK</u> Eelco Blok	Director	March 13, 2009
<u>/s/ ROBERT BRUMLEY</u> Robert H. Brumley	Director	March 13, 2009
<u>/s/ CHARLES CORFIELD</u> Charles N. Corfield	Director	March 13, 2009
<u>/s/ JOOST FARWERCK</u> Joost Farwerck	Director	March 13, 2009
<u>/s/ W. FRANK KING</u> W. Frank King	Director	March 13, 2009



## **Exhibit G**

### **Summary of Technical and Managerial Expertise**

Brief descriptions of the technical and managerial background and experience of key members of iBasis Retail's management team are provided below. The individuals responsible for iBasis Retail's Ohio operations are:

Ofer Gneezy, Chief Executive Officer  
Mark Flynn, Chief Legal Counsel and Secretary  
Richard Tennant, Chief Financial Officer  
Ajay Joseph, Chief Technology Officer of iBasis, Inc.  
Paul Floyd, Sr. VP Research and Development of iBasis, Inc.  
Alan Bugos, Vice President, Advanced Technology & Engineering of iBasis, Inc.  
Anthony S. Bloom, Vice President, Retail Services, iBasis, Inc.

All of these individuals may be contacted at iBasis Retail's principal place of business:

iBasis Retail, Inc.  
20 Second Avenue  
Burlington, MA 01803  
781-505-7500

#### **Ofer Gneezy, Chief Executive Officer**

Ofer Gneezy is President and Chief Executive Officer of iBasis Retail, Inc. He is also the President, Chief Executive Officer and Chairman of the Board of iBasis, Inc., a leader in international long distance VoIP services. Mr. Gneezy was a recipient of Pulver.com's Industry Pioneer Award and was named Best Business Leader for 2007 in the annual Capacity Magazine awards. Mr. Gneezy built iBasis, Inc. as the first provider of toll-quality VoIP service.

Prior to starting iBasis, Inc., Mr. Gneezy was president of Acuity Imaging, Inc., a multinational leader in industrial automation technology. Mr. Gneezy led Acuity to achieve significant increases in earnings, revenues and stockholder equity before successfully orchestrating the company's acquisition by RVSI, the second-largest company in the industry. The acquisition provided Acuity with strong financial backing and access to the semiconductor

industry while delivering liquidity to Acuity investors. Previously, as president and CEO of Automatix, Inc., Mr. Gneezy led the turnaround of the company to growth and sustained quarterly profitability and managed its merger with Itran, Inc. to form Acuity. Mr. Gneezy is a graduate of the Advanced Management Program at Harvard University's Graduate School of Business Administration and has an M.S. in engineering from M.I.T.

**Mark S. Flynn, Chief Legal Officer and Secretary**

Mark S. Flynn is Chief Legal Officer and Secretary for iBasis Retail, Inc. He also serves in these positions at iBasis, Inc. Mr. Flynn manages the legal affairs of the company and provides counsel on a range of related issues including corporate governance and regulatory compliance.

Mr. Flynn has substantial experience in corporate legal affairs including corporate governance and Sarbanes-Oxley compliance, acquisitions and divestitures, and corporate finance. Prior to joining iBasis, Mr. Flynn was Vice-President, General Counsel and Secretary for Imagistics International Inc., a NYSE-traded company engaged in the marketing, sales and service of document imaging equipment with revenues exceeding \$600 million and 3,500 employees in the U.S., Canada, and the U.K. He has also served in senior legal counsel positions at public and private companies in the chemicals and health care industries, including Senior Deputy General Counsel of Olin Corporation, a diversified chemicals and materials company.

**Richard Tennant, Chief Financial Officer**

Richard Tennant oversees the financial management of the company. Mr. Tennant has more than 20 years of experience in corporate finance and administration. Prior to joining iBasis

Retail, Inc. and iBasis, Inc., he was Vice-President, CFO and Treasurer for ScoreBoard, a software start-up company targeting the wireless carrier market. Previously, Mr. Tennant served as CFO of several private and public companies, including LTX Corporation, a semiconductor testing solutions vendor with annual revenues of more than \$200 million. Mr. Tennant also served as CFO for Netrix Corporation, a telecom equipment and software manufacturer.

**Ajay T. Joseph, Chief Technology Officer, iBasis, Inc.**

As Chief Technology Officer, Ajay Joseph is responsible for the technical strategy, innovation, and engineering of the iBasis Internet Telephony infrastructure. Since 1999, Mr. Joseph has led the network architecture, systems development and migration of the global iBasis network to an all IP, switch-less architecture. Prior to joining iBasis, Mr. Joseph was manager and architect of the IP Telecom division at GTE Internetworking responsible for new VoIP-based services. He also held senior level engineering and design positions at DeskNet Systems and NYNEX Science & Technology.

**Paul H. Floyd, Senior Vice President, Research and Development, iBasis, Inc.**

Paul Floyd has more than 20 years of experience in managing highly innovative and productive engineering organizations. Mr. Floyd most recently served as the Senior Vice President for the DSL business of AT&T spinout, Paradyne Networks, where he was responsible for engineering, product management, strategy, and planning. Mr. Floyd also held the position of Vice President of Research and Development at Paradyne, responsible for leading all of the product and technology development efforts within Paradyne. He also led the pioneering efforts around the development of ReachDSL technology and products, the industry's longest loop

reach DSL technology. Mr. Floyd spent the previous 13 years in various key senior-level engineering and design roles in both AT&T's Paradyne division and AT&T Bell Labs.

**Alan R. Bugos, Vice President, Advanced Technology & Engineering, iBasis, Inc.**

Alan Bugos has more than 17 years of hands-on experience in telecommunications, optical networking, data networking, and communications systems integration. Formerly, he was a Department Manager at GTE Internetworking's IP Telecom Group working on the development and deployment of VoIP and IP Telephony services for GTE's (now Genuity) GNI IP backbone. Prior to GTE Internetworking, Mr. Bugos was a Principal Member of Technical Staff at GTE Laboratories, focusing on high-speed multi-gigabit optical network design, "real-time" IP multimedia networking, data networking techniques, and DSL and xDSL for Internet services, and advanced voice/video technologies.

**Anthony S. Bloom, Vice President, Retail Services, iBasis, Inc.**

Tony Bloom's 24-year career in telecommunications has included executive management and strategic development experience with many publicly traded telecommunications conglomerates in the United States. Mr. Bloom is currently the Vice President for iBasis Retail prepaid products organization where he directs the sales, marketing and production business units. Tony Bloom most recently served as the executive director for Verizon's Business Solution Group channel program where he was responsible for the MCI channel partner sales for the U.S. Mr. Bloom also held the position of director in various key senior-level enterprise management roles in both MCI's Commercial Accounts and MCI-Worldcom's Major Accounts

divisions. He also held various senior-level positions at CTC Communications and Cable & Wireless.

## **Exhibit H**

### **List of Officers and Directors**

#### **Officers of iBasis Retail, Inc.**

<b>Name</b>	<b>Title</b>	<b>Address</b>
Ofer Gneezy	Chief Executive Officer	20 Second Avenue Burlington, MA 01803 781-505-7500
Mark Flynn	Secretary	20 Second Avenue Burlington, MA 01803 781-505-7500
Richard Tennant	Chief Financial Officer	20 Second Avenue Burlington, MA 01803 781-505-7500

#### **Directors of iBasis Retail, Inc.**

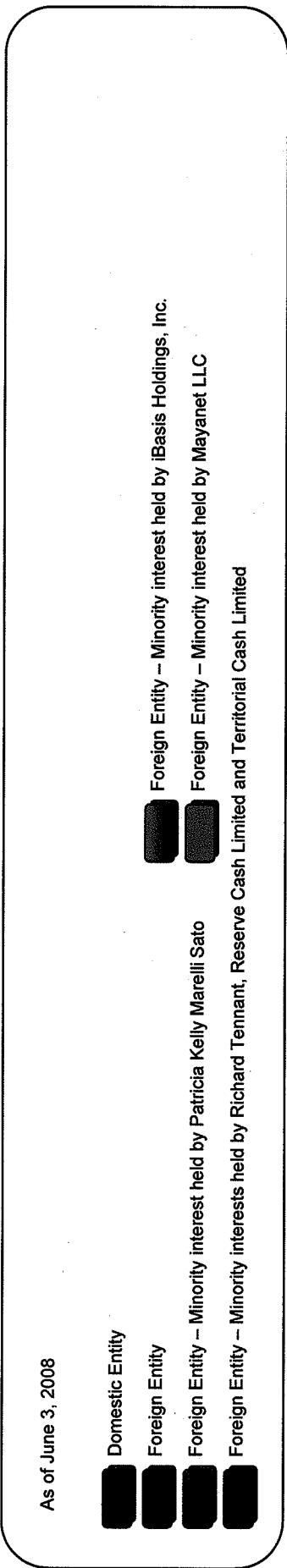
<b>Name</b>	<b>Title</b>	<b>Address</b>
Ofer Gneezy	Chief Executive Officer	20 Second Avenue Burlington, MA 01803 781-505-7500
Gordon Vanderbrug	Executive Vice President	20 Second Avenue Burlington, MA 01803 781-505-7500
Richard Tennant	Chief Financial Officer	20 Second Avenue Burlington, MA 01803 781-505-7500



## **Exhibit I**

### **Organizational Chart Depicting Applicant's Corporate Structure and Ownership**

**iBasis, Inc.**



As of June 3, 2008

Domestic Entity

### Foreign Entity

**Foreign Entity -- Minority interest held by Patricia Kelly Marelli Sato**

**Foreign Entity – Minority interests held by Richard Tennant, Reserve Cash Limited and Territorial Cash Limited**

**Foreign Entity --- Minority interest held by iBasis Holdings, Inc.**

**Foreign Entity – Minority interest held by Mavanet LLC**

## **Exhibit J**

### **Information regarding Similar Operations in Other States**

iBasis Retail is authorized to provide interexchange services in California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Maryland, Massachusetts, Michigan, Minnesota, New York, North Carolina, Oregon, Pennsylvania, South Carolina, Texas, Utah, Washington, West Virginia and Wisconsin. iBasis Retail is also in the process of seeking authorization in Alabama, Arizona, Arkansas, Hawaii, Iowa, Kansas, Louisiana, Missouri, Nebraska, Nevada, and Tennessee. Applicant has not been denied a request in any state.

## **Exhibit K**

### **Verification of Maintenance of Local Telephony Records**

Not applicable.

## **Exhibit L**

### **Verification regarding Compliance with Affiliate Transaction Requirements**

Not applicable.

**This foregoing document was electronically filed with the Public Utilities**

**Commission of Ohio Docketing Information System on**

**10/8/2009 5:06:46 PM**

**in**

**Case No(s). 09-0923-TP-ACE**

Summary: Application In the Matter of the Application of iBasis Retail, Inc. for Interexchange Telecommunications Authority within the State of Ohio electronically filed by Mrs. Jennifer A Cukier on behalf of iBasis Retail, Inc.