Item 2. Properties

We lease the following facilities:

Location	Square Footage	Expiration of Lease	Facility Use
Burlington, MA	44,265	April 2010	Headquarters and global network operations center
New York, NY	4,372	Various, 2009-2018	Internet central office
Miami, FL	10,500	February 2010	Partially sub-leased, partially vacant
Los Angeles, CA	3,156	April 2008	Internet central office

In addition to the facilities listed above, we have obtained collocation space in special facilities around the world that are dedicated to housing equipment of multiple competitive telephony carriers. We lease these smaller spaces to house Internet routing and related equipment. We lease collocation space in Frankfurt, Hong Kong, London, Paris, Sydney and Tokyo. We also rent smaller office space in London, Beijing, Buenos Aires, Dubai and Hong Kong. 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 and the Securities Exchange Act of 1934 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. The fairness hearing was held on April 24, 2006 and the motion for approval of the settlement is pending. Plaintiffs have continued to pursue their claims against the underwriters. The district court has 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 and in December 2006, the United States

Court of Appeals for the Second Circuit reversed the certification order. Since the pending settlement with the issuers involves parallel classes to those in the six focus cases, it is not expected that the district court will act favorably on the issuer settlement in its current form.

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 and intend to defend vigorously.

We cannot estimate potential losses, if any, from these matters or whether, in light of the Company's insurance coverage, any loss would be material to the Company's financial condition, results of operations or cash flows. As such, no amounts have been accrued as of December 31, 2006.

Actions Pursuant to Option Investigation

On December 21, 2006, two derivative actions naming us as a nominal defendant were filed in the United States District Court for the District of Massachusetts: *David Shutvet, Derivatively on Behalf of iBasis, Inc., v. Ofer Gneezy et al.,* U.S.D.C. Civil Action No. 06-12276-DPW; and *Victor Malozi, Derivatively on Behalf of iBasis, Inc., v. Ofer Gneezy et al.,* U.S.D.C. Civil Action No. 06-12277-DPW. The complaints in these two actions each name the same defendants: Ofer Gneezy, our President, Chief Executive Officer and Director; Gordon J. VanderBrug, our Executive Vice President, Assistant Secretary and Director; Richard G. Tennant, our Senior Vice President of Finance and Administration and Chief Financial Officer; Paul H. Floyd, our Senior Vice President of R&D, Engineering and Operations; Charles Corfield, Charles M. Skibo, W. Frank King, David Lee, and Robert H. Brumley, our Directors; Daniel Price, our former Senior Vice President of Speech Solutions and our former Director; John G. Henson, Jr., our former Vice President, Engineering and Operations; Michael J. Hughes, our former Chief Financial Officer and former Vice President of Finance and Administration; Charles Giambalvo, our former Senior Vice President of Worldwide Sales; Jonathan D. Draluck, our former Vice President, Business Affairs, and former General Counsel and former Secretary; and John Jarve, Charles Houser, and Carl Redfield, our former Directors. The complaints allege that the defendants caused or allowed our "insiders" to backdate their stock option grants, and caused or allowed us (i) to file materially false and misleading financial statements that materially understated our compensation expenses and materially overstated our quarterly and annual net income and earnings per share, and (ii) to make disclosures in its periodic filings and proxy statements that falsely portrayed our options as having been granted at exercise prices equal to the fair market value of our common stock on the date of the grant. The complaints also allege that certain defendants engaged in illegal insider selling of our common stock while in possession of undisclosed material adverse information. Based on these and other allegations, the complaints assert claims for: violation of Section 14(a) of the Exchange Act; disgorgement under the Sarbanes-Oxley Act of 2002; unjust enrichment; breach of fiduciary duty for approving improperly dated stock option grants to our executive officers; breach of fiduciary duties for insider selling and misappropriation of information; abuse of control; gross mismanagement; waste of corporate assets; an accounting; rescission of certain stock option contracts; and constructive trust. The complaints seek the following relief: damages in favor of us for the individual defendants' alleged wrongdoing; disgorgement of all bonuses or other incentive-based or equity-based compensation received by Mr. Gneezy and Mr. Tennant during any period for which we restate our financial results; a declaration that the director defendants caused us to violate Section 14(a) of the Exchange Act; certain corporate governance reforms; an accounting of all undisclosed backdated stock option grants, cancellation of all unexercised grants, and revision of our financial statements; disgorgement of all profits obtained by the defendants from the allegedly backdated stock option grants and related equitable relief; and an award to the plaintiffs of their costs and disbursements for the action, including reasonable attorney's fees and accountants' and experts' fees, costs and expenses.

On May 10, 2007, the United States District Court for the District of Massachusetts entered orders consolidating the above derivative actions under Civil Action No. 06-12276-DPW and requiring the plaintiffs to file a consolidated complaint by June 15, 2007. Our response to the consolidated complaint is due on August 3, 2007. Based on the allegations in the complaints presently on file, we anticipate that we will file a motion to dismiss the consolidated complaint at that time.

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 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 seeks documents and information from us relating to the grant of our options from 1999 to the present. We expect that the SEC will seek the testimony of individuals including certain of our executive officers. We are cooperating fully with the SEC investigation that is ongoing. There is no assurance that other regulatory inquiries will not be commenced by other U.S. federal, state or other regulatory agencies.

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 amounts have been accrued as of December 31, 2006.

Regulatory Proceedings

On June 30, 2006, the Federal Communications Commission ("FCC") issued an order requiring providers of prepaid calling cards that utilize IP to contribute to the Universal Service Fund ("USF") and pay access charges and other regulatory fees both in the future and for some prior period of time. In connection with our Retail business, we plan to absorb or pass along such future fees, to the extent permitted by law, which, based on current traffic mix, equal approximately 1.8% of revenue. We have filed an appeal of the retroactive aspect of the FCC Order with the United States Court of Appeals in Washington, D.C. In October 2006, we filed a motion to stay that aspect of the FCC Order pending the outcome of the appeal. On November 1, 2006, the Court deferred ruling on the stay request pending the FCC's ruling on a similar stay motion pending before the agency. The agency denied the stay request on March 29, 2007. As of December 31, 2006, we estimate that the maximum potential retroactive USF charge relating to our Retail business prior to the third quarter of the year ended December 31, 2006 would be approximately $2.6 million. As the amount of retroactive fees are not probable of being incurred, no amounts have been accrued as of December 31, 2006.

We are also party 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. Our employees have also been named in proceedings arising out of business activities in foreign countries. We intend to prosecute vigorously claims that we have brought and employ all available defenses in contesting claims against us, or our employees. Nevertheless, in deciding whether to pursue settlement, we will consider, among other factors, the substantial costs and the diversion of management's attention and resources that would be required in litigation. In light of such costs, we have settled various and in some cases similar matters on what we believe have been favorable terms which did not have a material impact our financial position, results of operations, or cash flows. The results or failure of any suit may have a material adverse affect on our business.

We cannot estimate the amount of losses, if any, from these matters, or whether any loss would be material to our financial condition, results or operations or cash flows. As such, no amounts have been accrued as of December 31, 2006.

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, 2006.

PART II

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

Market Information

Our common stock began trading publicly on The Nasdaq Global Market on November 10, 1999 and was traded under the symbol "IBAS." After we had failed to meet certain minimum listng requirements for The Nasdaq Stock Market, our common stock traded on the Nasdaq operated Over-the-Counter Bulletin Board from November 14, 2002 until June 20, 2006, under the stock symbol "IBAS". On June 21, 2006, our common stock resumed trading on The Nasdaq Global Market under the stock symbol "IBAS", after we met the requirements for relisting. In November 2006, we were notified by The Nasdaq Stock Market that our common stock was subject to delisting from The Nasdaq Global Market due to our failure to file our Quarterly Report on Form 10-Q for the third quarter in the year ended Decmeber 31, 2006 in a timely manner. We have subsequently received additional notices from The Nasdaq Stock Market stating that our failure to file our Annual Report on Form 10-K for the year ended December 31, 2006 and our Quarterly Report on Form 10-Q for the first quarter for the year ending December 31, 2007 in a timely manner could serve as an additional basis for the delisting of our common stock from The Nasdaq Global Market. The Nasdaq Stock Market has stayed the delisting of our common stock pending further action of the Nasdaq Listing and Hearing Review Council ("Listing Council"). On June 1, 2007 we submited additional information for the consideration of the Listing Council, including our plans to upate our SEC filings to meet The Nasdaq National Stock Market listing requirements and we requesed the Listing Council for an extension until June 30, 2007 to file our periodic reports. There can be no assurance that the listing of our common stock on The Nasdaq Global Market will be maintained.

The following table shows the range of the high and low closing per share prices of our common stock, as reported by Nasdaq Global Market, since June 21, 2006, and by the Over-the-Counter Bulletin Board for the periods prior to June 21, 2006. Over-the-Counter market quotations reflect interdealer prices, without retail mark-up, mark-down or commission and may not necessarily reflect actual transactions.

	High	Low
Fiscal 2006:		
Fourth Quarter	$ 8.62	$ 7.78
Third Quarter	8.90	7.74
Second Quarter	8.80	6.66
First Quarter	6.84	5.34
Fiscal 2005:		
Fourth Quarter	$ 8.25	$ 5.27
Third Quarter	10.26	7.20
Second Quarter	8.16	6.24
First Quarter	7.44	5.85

Stockholders

As of May 31, 2007, we had 203 stockholders of record. This does not reflect persons or entities who hold their stock in nominee or "street" name through various brokerage firms.

Reverse Stock Split

On May 2, 2006, after shareholder approval, we effected a one-for-three reverse stock split of our issued and outstanding shares of common stock. All share and per share amounts for all periods presented have been adjusted to reflect the reverse stock split.

Dividends

We have never declared or paid cash dividends on our common stock.

As soon as practicable following the closing of the proposed transaction with KPN, we will pay to our shareholders of record as of the close of business on the day immediately preceding the closing, a dividend in an aggregate amount of $113 million. The funds used to pay the dividend will come from cash on hand and the proceeds of the proposed transaction. Also, under the terms of outstanding warrants for our common stock, upon exercise of such warrants after the closing of the proposed transaction, the holders of the warrants shall be 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 proposed transaction, in addition to the number of shares of common stock issuable upon such exercise.

Issuer Purchases of Equity Securities

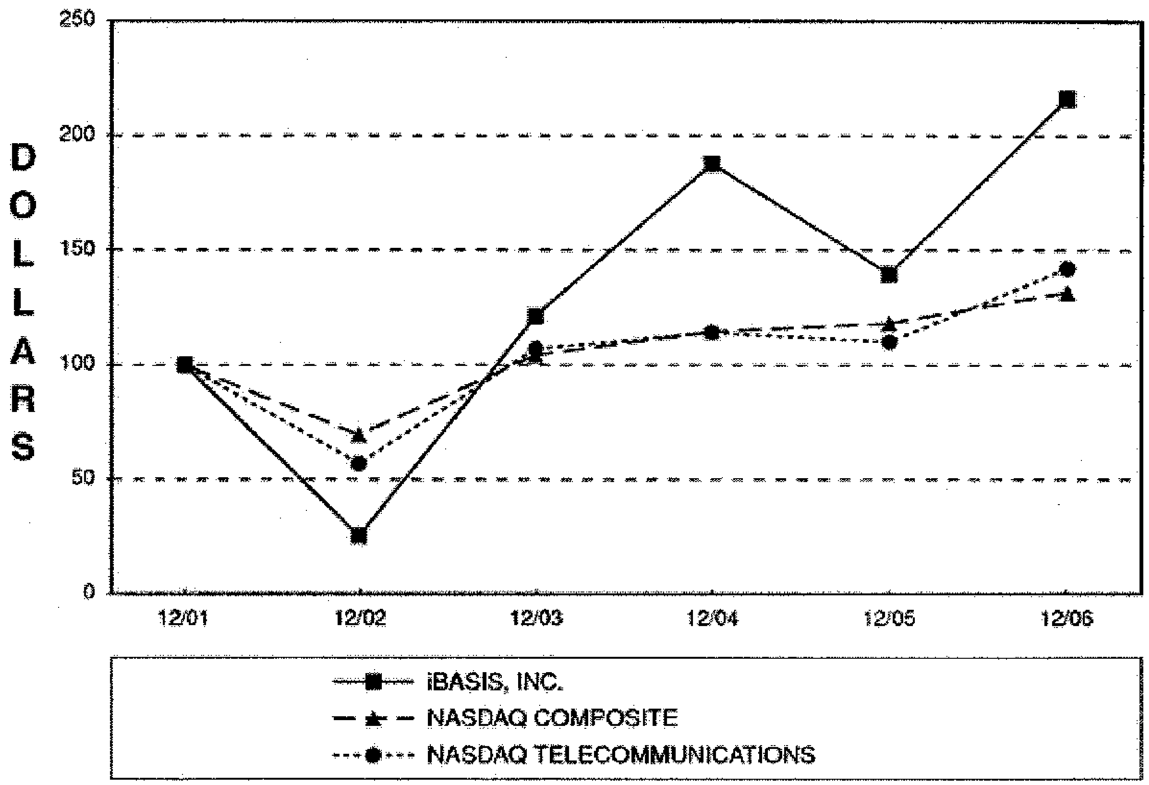
During the year ended December 31, 2006, we purchased an aggregate of 377,101 of our common stock under a $5 million stock repurchase program publicly announced in October 2005.

In February 2006, we announced a $10 million increase in our stock repurchase program. We have made no further repurchases of our common stock under our stock repurchase program since March 2006 and we have no plans to make any further repurchases under this program.

Performance Graph

The following graph compares the annual percentage change in our cumulative total stockholder return on our common stock during a period commencing on December 31, 2001 and ending on December 31, 2006 (as measured by dividing (i) the sum of (A) the cumulative amount of dividends for the measurement period, assuming dividend reinvestment, and (B) the difference between our share price at the end and the beginning of the measurement period; by (ii) our share price at the beginning of the measurement period) with the cumulative total return of the Nasdaq Composite Index and the Nasdaq Telecommunications Index during such period. We have not paid any dividends on our common stock, and we do not include dividends in the representation of our performance. The stock price performance on the graph below does not necessarily indicate future price performance. The following graph shall not be deemed to be filed with the SEC under the Securities Act of 1933, as amended, or the Securities and Exchange Act of 1934, as amended, or incorporated by reference in any document so filed.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among iBasis Inc., The NASDAQ Composite Index
And The NASDAQ Telecommuncations Index



*$100 invested on 12/31/01 in stock or index-including reinvestment of dividends.
Fiscal year ending December 31.

	12/01	12/02	12/03	12/04	12/05	12/06
iBasis, Inc.	**100.00**	**25.19**	**121.37**	**187.79**	**139.69**	**216.28**
NASDAQ Composite	**100.00**	**69.53**	**104.28**	**114.68**	**118.32**	**131.85**
NASDAQ Telecommunications	**100.00**	**56.94**	**107.05**	**114.25**	**110.17**	**142.20**

Item 6. *Selected Financial Data*

The following selected consolidated financial data with respect to our company for each of the five years in the period ended December 31, 2006 has been restated and is derived from our consolidated financial statements, which financial statements as of December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004 have been audited by Deloitte & Touche LLP, independent registered public accountants. Such consolidated financial statements and the report thereon are included elsewhere in this report. The information below should be read in conjunction with the consolidated financial statements and notes thereto and with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other financial data included elsewhere in this report. Our historical results of operations are not necessarily indicative of results of operations to be expected for any future period.

See Note 3, "Restatement of Consolidated Financial Statements," of the Notes to Consolidated Financial Statements for more detailed information regarding the restatement of our consolidated financial statements.

During July 2002, we sold our Speech Solutions Business. Accordingly, the Consolidated Statements of Operations have been reclassified to present the results of the Speech Solutions Business separately from continuing operations as discontinued operations.

	Year Ended December 31,								
	2006	2005	2004	2003			2002		
		(as restated) (1)	(as restated) (1)	(as previously reported)	(adjustments) (unaudited)	(as restated) (2)	(as previously reported)	(adjustments) (unaudited)	(as restated) (2)
	(In thousands, except per share amounts)								
Consolidated Statements of Operations Data:									
Net revenue	$ 511,083	$ 385,485	$ 263,678	$ 178,159	$ —	$ 178,159	$ 164,942	$ —	$ 164,942
Costs and operating expenses:									
Data communications and telecommunications (excluding depreciation and amortization)	447,697	336,152	225,169	152,853	187	153,040	142,847	(219)	142,628
Research and development	13,498	12,568	14,013	13,387	395	13,782	17,781	1,777	19,558
Selling and marketing	16,347	11,712	9,351	7,513	494	8,007	11,279	1,220	12,499
General and administrative	25,062	15,543	13,162	8,174	50	8,224	24,387	1,514	25,901
Depreciation and amortization	7,055	6,507	10,437	20,065	356	20,421	31,871	33	31,904
Write-off of leasehold improvements	1,047	—	—	—	—	—	—	—	—
Restructuring costs	1,272	218	165	—	—	—	5,536	—	5,536
Merger related expenses	2,996	—	—	—	—	—	—	—	—
Non-cash stock-based compensation(3)	—	—	—	86	(86)	—	967	(967)	—
Loss on sale of messaging business	—	—	—	—			2,066		2,066
Total costs and operating expenses	514,974	382,700	272,297	202,078	1,396	203,474	236,734	3,358	240,092
Income (loss) from operations	(3,891)	2,785	(8,619)	(23,919)	(1,396)	(25,315)	(71,792)	(3,358)	(75,150)
Interest income	1,887	1,109	218	161		161	1,290		1,290
Interest expense	(337)	(2,601)	(4,249)	(3,967)		(3,967)	(11,608)		(11,608)
Gain on bond repurchases and exchanges	—	—	—	16,615		16,615	25,790		25,790
Other expense, net	(188)	(324)	(184)	(180)		(180)	(330)		(330)
Loss on long-term non-marketable security	—	—	(5,000)	—		—	—		—
Foreign exchange (loss) gain	372	(939)	339	509		509	201		201
Debt conversion premium and transaction costs	—	(1,975)	—	—		—	—		—
Debt refinancing charges:									
Transaction costs	—	—	(2,159)	—		—	—		—
Additional interest expense, net	—	—	(481)	—		—	—		—
Loss before taxes from continuing operations	(2,157)	(1,945)	(20,135)	(10,781)	(1,396)	(12,177)	(56,449)	(3,358)	(59,807)
Income tax expense	(37)	(93)	(50)	(157)		(157)	(52)		(52)
Loss from continuing operations	(2,194)	(2,038)	(20,185)	(10,938)	(1,396)	(12,334)	(56,501)	(3,358)	(59,859)
Income (loss) from discontinued operations	—	—	1,861	1,251		1,251	(65,222)		(65,222)
Net loss	$ (2,194)	$ (2,038)	$ (18,324)	$ (9,687)	$ (1,396)	$ (11,083)	$ (121,723)	$ (3,358)	$ (125,081)
Basic and diluted net loss per share:									
Loss from continuing operations	$ (0.07)	$ (0.08)	$ (1.20)	$ (0.73)	$ (0.10)	$ (0.83)	$ (3.75)	$ (0.23)	$ (3.98)
Income (loss) from discontinued operations	—	—	0.11	0.08		0.08	(4.33)	—	(4.33)
Basic and diluted net loss per share	$ (0.07)	$ (0.08)	$ (1.09)	$ (0.65)	$ (0.10)	$ (0.75)	$ (8.08)	$ (0.23)	$ (8.31)
Basic and diluted weighted average common shares outstanding	33,198	26,745	16,838	14,899		14,899	15,055		15,055

	Year Ended December 31,										
	2006	2005	2004			2003			2002		
						(In thousands)					
		(as restated) (1)	(as previously reported)	(adjustment)	(as restated) (2)	(as previously reported)	(adjustment)	(as restated) (2)	(as previously reported)	(adjustment)	(as restated) (2)
Consolidated Balance Sheet Data:											
Cash and cash equivalents, restricted cash and short-term marketable securities	$ 54,071	$ 44,414	$ 38,825	$ —	$ 38,825	$ 17,270	$ —	$ 17,270	$ 32,317	$ —	$ 32,317
Working capital	25,285	30,795	30,774	(544)	30,230	3,264	(350)	2,914	21,906	(122)	21,784
Total assets	137,664	106,151	87,776	(466)	87,310	67,538	(223)	67,315	98,524	134	98,658
Long-term debt, net of current portion	755	2,216	65,933		65,933	65,829		65,829	93,590		93,590
Stockholders' equity (deficit)	37,381	39,403	(23,893)	(858)	(24,751)	(42,108)	(573)	(42,681)	(33,972)	12	(33,960)

(1) See Note 3, "Restatement of Consolidated Financial Statements," of the Notes to Consolidated Financial Statements.

(2) See Explanatory Note above. The restated amounts for these periods are unaudited.

(3) Previously reported stock-based compensation amounts in 2003 and 2002 have been reclassified to conform to the current presentation.

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

Overview

We are a leading provider of international communications services and a provider of retail prepaid calling services. Our operations consist of our Voice-Over-Internet-Protocol ("VoIP") trading business ("Trading"), in which we connect buyers and sellers of international telecommunications services, and our retail services business ("Retail"). In the Trading business we receive voice traffic from buyers—originating carriers who are interconnected to our network via VoIP or traditional time division multiplexing ('TDM") connections, and we route that traffic over the Internet to sellers—local service providers and carriers in the destination countries with whom we have established agreements to manage the completion or termination of the call. We use proprietary, 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, consumer VoIP companies, telephony resellers and other service providers worldwide. We have call termination agreements with local service providers 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 and by introducing cost-effective solutions for our customers to interconnect with our network. Our Trading products include iBasis Directs™, which features our direct routes to more than 100 countries, which are our most cost-efficient routes. Designed for carrier customers with sophisticated Least Cost Routing capabilities, Directs offers our most competitive rates. We also offer our PremiumCertified® international routing product which features routes to more than 700 destinations that are actively monitored and managed to deliver a level of quality that is equal to or exceeds the highest industry benchmarks for retail quality. PremiumCertified is designed to take advantage of third-party or off-net routes to provide thorough worldwide coverage for customers, and enhances our ability to compete for retail international traffic from existing customers as well as from mobile operators and consumer VoIP providers.

In targeting the emerging consumer VoIP providers, we have expanded our DirectVoIP™ IP interconnection offering with DirectVoIP Broadband, which addresses requirements that are specific to the growing consumer VoIP market. DirectVoIP Broadband includes our 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. We have approximately 60 customers in the consumer VoIP market, including leaders among the emerging independent providers and cable operators, and we believe this market offers significant growth potential for us.

Our Retail business was launched in late 2003, with the introduction of our retail prepaid calling cards, which are marketed through distributors primarily to ethnic communities within major metropolitan markets in the U.S.. In September 2004, we expanded our Retail business segment with Pingo®, a prepaid calling service offered directly to consumers through an eCommerce web interface. Both the prepaid calling card business and Pingo leverage our existing international VoIP 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. Pingo is sold directly to consumers and business customers on a prepaid basis. Revenues from our Pingo services were not material in 2006, 2005 and 2004.

Restatement of Consolidated Financial Statements, Summary of Historical Granting Process and Determination of Measurement Date and Related Proceedings

Restatement of Consolidated Financial Statements

In conjunction with the preparation and filing of our Form 10-Q for the three months ended June 30, 2006, we performed an internal review of our historical option grants from January 1, 2004 through

May 2006 to discern any patterns relating to the timing and pricing of option grants. This internal review indicated that certain stock options grants were made at a relatively low price, compared to the price of our common stock in the days around the date of the stock option grant. In reviewing this information, our management did not believe that there would be a potential change in the measurement dates for these grants. On August 9, 2006, we filed our Form 10-Q for the quarter ended June 30, 2006.

At a meeting of our Board of Directors held on August 10, 2006, the status of the internal review was discussed. Subsequent to this meeting, our Executive Management and Board of Directors became aware, based on information provided to them by our former Vice President of Business Affairs and General Counsel, of email messages that he had written or received indicating that the date and exercise price of certain option grants may have been determined with hindsight.

On August 20, 2006, following review of the email messages and internal review, our Board of Directors formed a Special Committee of independent directors to commence a voluntary investigation of our historical stock option grants and practices. The Special Committee's investigation considered evidence of all stock options grants for the period December 1999 through May 2006. The Special Committee was given broad authority to investigate and address our historical stock option grants and practices. The Special Committee was composed of two independent members of our Board of Directors, W. Frank King and Robert H. Brumley. The Special Committee retained the law firm of Goodwin Procter LLP as its independent outside counsel and Goodwin Procter LLP hired Law and Economics Consulting Group as independent accounting experts to aid in its investigation.

On October 17, 2006, the Special Committee concluded that the measurement dates for determining the accounting treatment of certain historical stock option grants differed from the measurement dates used by us in preparing our financial statements. Because the prices at the originally stated grant dates were, in certain cases, lower than the prices on the actual dates of the determination, we determined we should have recognized material amounts of stock-based compensation expense which were not accounted for in our previously issued financial statements. In certain instances, the approval date of an option grant could not be determined with certainty. In addition, the terms of an option grant, including exercise price and number of shares, may not have been final on the date of approval. In those instances, we used other relevant available evidence to determine the most likely measurement date for the option grant. The Special Committee also found that in a number of instances the date and exercise price of option grants had been determined with hindsight to provide a more favorable price for such grants.

In those instances where the approval date of the stock option grant could not be determined with certainty, or the terms of the option grant, including exercise price and number of shares were not final on the determined date of approval, we used a consistent methodology to determine the most likely measurement date of the option grant. In determining a measurement date, we considered the date by which both approval of the stock option grant had been obtained and the terms of the option grant, including exercise price and number of shares, were final.

Summary of Historical Granting Process and Determination of Measurement Dates

Pre IPO Approval Process

Since the Company's inception in 1997 through November 1999, the month in which we went public, the majority of the stock option grants were approved in meetings of our Compensation Committee or Board of Directors.

Post IPO Approval Process

From December 1999, the month in which the first post IPO stock option grant was made, to February 2002, we obtained approval for the majority of option grants through the practice of sending a unanimous written consent ("UWC") to our Compensation Committee that contained an *"as of"* grant date and exercise price, and a list of option recipients and shares awarded by recipient attached to the UWC. Beginning in May 2002, our General Counsel's practice changed to sending a UWC, with a blank grant date and blank exercise price, to our Compensation Committee members for approval, with a list of option recipients and shares to be awarded by recipient attached.

December 1999 to February 2002

Between December 1999 and February 2002, we had a total of twenty-three stock option grants. Of the twenty-three, we have evidence of seven option grants that were approved by UWCs that contained grant dates and exercise prices when the UWCs were sent to the Compensation Committee for approval. For eight other option grants approved by a UWC during this period, we do not have evidence of what the UWC contained when it was sent to the Compensation Committee for approval. Compensation Committee members generally returned their signed UWC signature pages to our General Counsel. The final UWC was then completed by our General Counsel, including attaching the previously obtained signature pages of the Compensation Committee members.

Of the remaining eight grants which occurred during the period from December 1999 to February 2002, one employee option grant was approved in a meeting of our Compensation Committee and one Director grant was approved in a meeting of our Board of Directors. The documentation of these meetings included the grant date, exercise price, option recipients, shares awarded and vesting terms. The remaining six option grants had no evidence or documentation supporting approval of the option grant, other than certain employee stock option agreements and the date of entry into our stock option tracking system.

During this period, the approved list of stock option grants, including the stock option grant date and exercise price, was then communicated by our General Counsel to our Human Resources personnel for entry into our stock option tracking system. With respect to the grants in which the exercise price of the option was initially set forth in the UWC circulated to the Compensation Committee (provided the list of option recipients and shares awarded were final), we believe that on the date the Compensation Committee approved the option grant all of the terms of the option grant, including exercise price, were known with finality, as such terms were included in the UWC approved by the Compensation Committee and such terms were also consistent with the information that was ultimately entered into our stock option tracking system and communicated to employees.

May 2002 to May 2006

Between May 2002 and May 2006, we had a total of thirty-one stock option grants. Of the thirty one grants, we have evidence of seventeen option grants for which the UWC, when sent to our Compensation Committee, or Board of Directors for approval, did not contain a grant date and exercise price. Sometime after sending the UWCs out to Compensation Committee members for signatures, the date of the stock option grant and the stock option exercise price (equal to the closing price of our common stock on the stated grant date) were inserted into the final UWC by our General Counsel. We have evidence for one grant in which the UWC, when sent to the Compensation Committee, contains a grant date and an exercise price. Compensation Committee members generally returned their signed UWC signature pages to our General Counsel. For eight other option grants during this period, we did not have evidence of what the UWC contained when it was sent to the Compensation Committee for approval. Once signed UWCs were obtained the approved list of stock option grants, including the stock option grant date and exercise price, was then communicated by our General Counsel to our Human Resources personnel for entry into our stock option tracking system.

Three other employee option grants were approved in meetings of our Compensation Committee and one non-employee Director grant was approved in a meeting of our Board of Directors. The documentation of these meetings included the grant date, exercise price, option recipients, shares awarded and vesting terms. In addition, there was one option grant during this period for which no evidence or documentation supporting approval of the option grant could be found, other than certain employee stock option agreements and the date of entry into our stock option tracking system.

For each of our past stock option grants, we determined a measurement date using the following criteria:

1) For stock option grants approved at a meeting of either our Board of Directors or our Compensation Committee and evidenced by meeting minutes, the date of the meeting was determined to be the measurement date, provided the terms of the option grant, including exercise price and number of shares, were final on the date of the meeting.

2) For stock option grants approved by the members of our Compensation Committee through the process of signing UWCs, the following criteria were used to determine the measurement date of the grant:

    a) If there was evidence of the date of signature for all of our Compensation Committee members, the date that the last Compensation Committee member signed the UWC was determined to be the measurement date, provided the terms of the option grant, including exercise price and number of shares, were final on that date;

    b) If there was evidence of the date of signature for all of our Compensation Committee members, other than our Chief Executive Officer when he was a member of the Compensation Committee, the date that the last Compensation Committee member signed the UWC was determined to be the measurement date, provided the terms of the option grant, including exercise price and number of shares, were final on that date.

3) If there was no evidence that grants were approved through the process of signing UWCs, or there was no evidence as to the date of the signatures on the UWCs by Compensation Committee members we considered email evidence to support the approval date.

    We determined the measurement date based on the date of statements made in email correspondence that indicated that the stock option grant had been approved by all of the members of our Compensation Committee, provided the terms of the option grant, including exercise price and number of shares, were final on that date. We considered emails from Compensation Committee members indicating the date of approval of the option grant and/or emails from our legal or human resources personnel indicating the date of approval of the option grant.

4) If there was a Form 3 or Form 4 filing associated with the option grant, we used the following criteria to determine the measurement date of the grant:

    a) If an officer or director required to file reports under Section 16 of the Securities Exchange Act of 1934, as amended, filed a Form 3 or Form 4, we determined the measurement date to be the date that the Form 3 or Form 4 was filed;

    b) If employees who were not Section 16 officers were included in the grant with Section 16 officers who filed a Form 3 or Form 4 and the number of shares attributable to employees who were not Section 16 officers were determined with finality at the time of the filing, we determined the measurement date to be the filing date of the Form 3 or Form 4 as it provided finality as to the exercise price.

5) If we did not have any corroborating evidence to indicate the date the stock option grant had been approved by all of the members of our Compensation Committee, and the filing of a Form 3 or Form 4 was not applicable, we looked for evidence that indicated the date on which the UWC was sent for signature, via email or fax, from us to the Compensation Committee members. If this evidence existed, we analyzed the number of days it took for Compensation Committee members to return the signed UWCs. A range of response time was determined by individual Compensation Committee member and used to develop a response time range for the Compensation Committee, as a group, during specific periods, as the composition of the Compensation Committee members changed over time. Based on this analysis, four different ranges were determined. The range of response times from Compensation Committee members varied from a minimum of 1 to 2 days, for which there was one instance, to a maximum of 0 to 91 days, for which there were two instances. Based on the range of response time, we determined the measurement date to be the last day of the response time period, provided the option terms were final on this date, as we have determined that this is the date by which approval is most likely to have been obtained.

6) In instances where there was no evidence of the approval of the grant and/or finality of the option recipients and grant terms, we determined the measurement date based on the last date of entry for these stock options into our stock option tracking system. This date was deemed to be the most likely approval date as our policy and historical practice was to enter stock option grants into its stock option tracking system only after we believed that the option grants had been approved.

The measurement dates we determined for past stock option grants, using the criteria as described above, resulted in additional stock-based compensation of approximately $10.0 million for the years ended December 31, 2000 through December 31, 2005 and $37,000 and $57,000 for the three months ended March 31, 2006 and June 30, 2006, respectively. The measurement date that we determined for one stock option grant dated May 25, 2000 resulted in approximately $7.7 million of the $10.0 million of additional stock-based compensation for years ended December 31, 2000 through December 31, 2005. For this particular grant, we could not determine with certainty the date of approval of such option grant. As a result, we determined the measurement date for the May 25, 2000 stock option grant to be the last day of the response period for Compensation Committee members to return their signed UWCs under criteria #5 as described above.

A summary of the additional stock-based compensation, by year, with the most significant stock option grants shown separately, is as follows:

(In thousands)	Year Ended December 31,						
Grant Date	2000	2001	2002	2003	2004	2005	Total
May 25, 2000	$ 1,540	$ 2,699	$ 3,028	$ 281	$ 135	$ —	$ 7,683
Nov. 15, 2001			554	391	39	39	1,023
Aug. 11, 2003				47	185	162	394
All other grants	118	186	196	92	144	136	872
Total	$ 1,658	$ 2,885	$ 3,778	$ 811	$ 503	$ 337	$ 9,972

Many of our measurement date conclusions are dependent on the facts and circumstances of each stock option grant and involved the application of significant management judgment. We believe the revised measurement dates we determined for option grants under criteria #4, #5 and #6 of our methodology, as described above, required the most judgment. As the revised measurement date may not be the actual measurement date, we performed several analyses to compare the impact on compensation of selecting measurement dates based upon the above described methodology to what would have resulted under different criteria for option grants where we determined the revised measurement date using criteria #4, #5 and #6 of our methodology.

In the first analysis, we considered that the measurement dates for eight stock option grants, where we had used the last day of a Compensation Committee member response period as the approval date (criteria #5), to be the date using both the lowest and highest stock price associated with a Compensation Committee approval period. Had we applied these alternate approaches, the first alternate measurement dates would have resulted in $4,533,000 in additional cumulative stock-based compensation charges being recorded from 2000 through June 30, 2006 for the alternative approach of using the highest stock price within the response period. The May 25, 2000 stock option grant accounts for approximately $4,470,000 of the additional $4,533,000 of stock-based compensation charges that would be recorded using the alternate approach of the highest stock price within the response period. The second alternate measurement dates would have resulted in $24,000 less in additional cumulative stock-based compensation charges being recorded from 2000 through June 30, 2006 for the alternative approach of using the lowest stock price within the response period. In addition, we also considered the impact on four grants where the approval response time as determined was later than the date such grants were entered into our option tracking system. In such cases, if the last date of entry into our option tracking system was used instead, the compensation charge would have been $28,000 less for the period.

In the second analysis, we considered the measurement dates for the twenty-five stock option grants, where we had used the last date of entry into our stock option tracking system as the measurement date (criteria #6), to be the date using both the lowest and highest stock price between the earliest possible approval date of the grant and the last date of entry into our stock option tracking system. Had we used these alternative measurement dates, this would have resulted in approximately $0.9 million in additional cumulative stock-based compensation using the highest stock price, and approximately $0.9 million less in additional cumulative stock-based compensation using the lowest stock price, being recorded from 2000 through June 30, 2006.

In the third analysis we considered the measurement dates for the nine stock option grants, where we used the dates of Form 3 or Form 4 filings as the measurement date (criteria #4), to be the date using both the lowest and highest stock price between the earliest possible date of approval of the grant and the date of the Form 3 or Form 4 filings. Had we used these alternative measurement dates, this would have resulted in $33,000 of additional cumulative stock-based compensation using the highest stock price, and approximately $0.3 million less in additional cumulative stock-based compensation using the lowest stock price, being recorded from 2000 through June 30, 2006.

We believe our methodology results in the most likely measurement dates for our stock option grants.

As a result of the Special Committee's investigation, we have restated our consolidated financial statements for the years ended December 31, 2005 and 2004 in this Form 10-K. The impact of these errors also extended to the periods prior to the year ended December 31, 2004. In the restated consolidated financial statements included in this Form 10-K the cumulative impact of the errors as of December 31, 2003 is represented as an increase to beginning accumulated deficit as of January 1, 2004. For further information, see Explanatory Note above and Note 3, "Restatement of Consolidated Financial Statements," to the Notes to Consolidated Financial Statements.

As a result of determining revised measurement dates, we have also recorded payroll withholding tax related adjustments for certain options previously classified as Incentive Stock Option ("ISO") grants under the Internal Revenue Service Code of 1986, as amended ("the Code"). Such options were determined to have been granted with an exercise price below the fair market value of the Company's stock on the revised measurement date. As a result such options do not qualify for ISO tax treatment. The disqualification of ISO classification and the resulting conversion to non-qualified stock option status results in additional withholding taxes on exercise of such options. We have accordingly recorded a tax liability of $0.5 million, as of December 31, 2006 in connection with the disqualification of such ISO tax treatment.

In addition, as a result of the change in the measurement dates of certain stock option grants, certain options vesting subsequent to December 2004 result in non-qualified deferred compensation for purposes of Section 409A of the Code, and holders are subject to an excise tax on the value of the options in the year in which they vest. We have concluded that it is probable that we will implement a plan to assist the affected employees for the amount of this tax, or adjust the terms of the original option grant, which would also have financial statement ramifications. We and our executive officers and directors agreed to amend certain outstanding stock options vesting after December 2004 that were determined to have been granted with exercise prices below the fair market value of our common stock on the legal grant date. In December, 2006, we and our executive officers and directors agreed to amend each of these options to increase the option exercise price to the fair market value on the revised measurement date. As these amendments involved no consideration to our executive officers and directors, we will not recognize any expense associated with these modifications in accordance with SFAS 123R.

The restatement of prior year financial statements also includes adjustments for other errors that were not previously recorded because we believed the amount of any such errors, both individually and in the aggregate, were not material to our historical consolidated financial statements. Such errors primarily related to the recording of deferred income, classification of reserves for customer disputes, adjustments to accruals, and fixed asset depreciation.

Our restated consolidated financial statements reflect an increase in net loss of approximately $10.6 million for the periods 2000 through December 31, 2005 consisting principally of non-cash adjustments to stock-based compensation expense resulting from the stock option grant and exercise practices discussed above. The expenses for the periods 2000 to 2003 are reflected as an increase to accumulated deficit in the opening balance sheet for 2004 of approximately $9.5 million.

In accordance with the determinations of the Special Committee's investigation, our Board of Directors terminated the employment of our former Vice President, Business Affairs and General Counsel and directed our Compensation Committee to adjust downward the compensation for fiscal year 2006 for both our Chief Executive Officer, Ofer Gneezy, and our Executive Vice President, Gordon VanderBrug, because their oversight of our stock option granting practices was inadequate. Additionally, the Special Committee recommended, and we have implemented, changes to our stock-based compensation transaction procedures and approval policies that require additional and more systematic authorization to ensure that all stock option transactions adhere to our approval process and stated policies, and that all such transactions are properly recorded in our stock administration systems and have appropriate supporting documentation.

The discussion and analysis set forth below in this Item 7 has been amended to reflect the restatement as described above in the Explanatory Note to this Annual Report on Form 10-K and in Note 3, "Restatement of Consolidated Financial Statements," to the Notes to Consolidated Financial Statements. For this reason, the data set forth in this section may not be comparable to discussions and data in our previously filed Annual Reports on Form 10-K.

Related Proceedings

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 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 seeks documents and information from us relating to the grant of our options from 1999 to the present. We expect that the SEC will seek the testimony of individuals including certain of our executive officers. We are cooperating fully with the SEC investigation that is ongoing. There is no assurance that other regulatory inquiries will not be commenced by other U.S. federal, state or other regulatory agencies.

We have incurred substantial expenses for legal, accounting, tax and other professional services in connection with the Special Committee investigation, our internal review of our historical financial statements, the preparation and audit of the restated financial statements, the SEC investigation and related civil derivative litigation. These expenses were approximately $2.3 million for the year ended December 31, 2006. We have continued to incur significant expense in connection with these matters since December 31, 2006.

NASDAQ Listing

On June 21, 2006, our common stock began trading again on the NASDAQ National Market under the stock symbol "IBAS". On May 3, 2006, we affected a one-for-three reverse stock split and subsequently submitted an application to NASDAQ to achieve this relisting.

On November 12, 2006, the Nasdaq Listings Qualification Panel ("Nasdaq Panel") notified us that our common stock was subject to delisting from the NASDAQ National Market as a result of our failure to timely file our Form 10-Q for the third quarter of 2006. In January 2007, the Nasdaq Panel granted our request for continued listing on the NASDAQ National Market through April 26, 2007. In March 2007, the Nasdaq Listing and Hearing Review Council (the "Listing Council") informed us they had stayed the April 26, 2007 deadline for the delisting of our common stock, pending their further review. On March 20, 2007 and May 16, 2007, we received additional Nasdaq staff determination letters notifying us that our failure to timely file our Form 10-K for the period ended December 31, 2006 and our Form 10-Q for the quarter ended March 31, 2007, respectively, could serve as an additional bases for the delisting of the Company's securities from The Nasdaq Stock Market. On June 1, 2007 we submited additional information for the consideration of the Listing Council, including our plans to update our SEC filings to meet the Nasdaq National Stock Market listing requirements and we requested the Listing Council for an extension to June 30, 2007 to file our periodic reports.

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

On June 21, 2006, we announced the signing of a definitive agreement to merge the international wholesale voice business of Royal KPN N.V. ("KPN") into iBasis. Pursuant to the Share Purchase and Sale Agreement, we will acquire KPN's subsidiary KPN Global Carrier Services and receive $55 million in cash in exchange for newly-issued shares of our common stock representing, on a post issuance basis, 51% of our issued and outstanding shares of common stock and outstanding in-the-money stock options and warrants, or approximately 40 million shares. As of December 31, 2006, the newly-issued shares to KPN would represent approximately 55% of our issued and outstanding common shares. Our shareholders of record immediately prior to closing will receive a cash dividend of $113 million as soon as practicable following the closing. In connection with payment of the dividend, we will adjust the exercise price and number of shares to be issued upon exercise of our outstanding common stock options to preserve their value.

On April 27, 2007, we announced that the Company and KPN had amended the Share Purchase and Sale Agreement to extend the outside date for completion of the transaction to October 31, 2007. Previously, in December 2006, we announced that the Company and KPN had extended the outside date for completion of the transaction from December 31, 2006 to April 30, 2007. The proposed transaction is subject to customary closing conditions and the approval of iBasis shareholders.

Although we will be legally acquiring KPN Global Carrier Services, after the transaction is completed, the former sole stockholder of KPN Global Carrier Services (a subsidiary of KPN), will hold a majority of our outstanding common stock. Accordingly, for accounting and financial statement purposes, the transaction will be treated as an acquisition of iBasis by KPN Global Carrier Services under the purchase method of accounting. Under the purchase method of accounting, our assets and liabilities will be, as of the closing date of the transaction, recorded at their fair value and added to the assets and liabilities of KPN Global Carrier Services, including an amount for goodwill representing the difference between the deemed purchase price of iBasis and the fair value of our identifiable net assets. We have incurred merger related expenses of $3.0 million through December 31, 2006, consisting primarily of investment banking advisory services, legal and accounting fees. Such amounts have been expensed because we are the accounting acquiree.

Critical Accounting Policies

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. 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, our revenue transactions are derived from the resale of international minutes of calling time. We recognize revenue in the period the service is provided, net of revenue reserves for potential billing disputes, provided the collection of amounts billed is reasonably assured. Disputes can result from disagreements with customers regarding the duration, destination or rates charged for each call. For our Retail business, revenue is deferred upon activation of the 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.

Short-term marketable investments. Our investments are classified as available-for-sale, carried at fair value and consist of securities that are readily convertible into cash, including government securities and commercial paper, with original maturities at the date of acquisition ranging from 90 days to one year. As our investments are classified as available-for-sale, we are only exposed to charges to our results of operations in the event of a sale or an impairment of a security.

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 take a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. We have been able to mitigate our credit risk, in part, by using reciprocal arrangements with customers, who are also iBasis suppliers, to offset our outstanding receivables, as well as requiring letters of credit and prepayments for certain customers. A majority of our accounts receivable are from international carriers. For financial information about geographic areas and significant customers, see Note 5, "Business Segment and Geographic Information" to our Consolidated Financial Statements.

Stock-based Compensation—Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards 123R, *"Share-Based Payment"* ("SFAS 123R"), which require us to record compensation expense related to the fair value of our stock-based compensation awards. Prior to January 1, 2006, we accounted for our stock-based compensation in accordance with Accounting Principles Board ("APB") Opinion 25, "Accounting for Stock Issued to Employees," and related interpretations.

We elected to use the modified prospective transition method as permitted under SFAS 123R and, therefore, have not restated our financial results for the prior periods to reflect the fair value of stock-based compensation awards. Under this transition method, stock-based compensation expense for the year ended December 31, 2006 includes 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. Stock-based compensation expense for all stock option awards granted subsequent to December 31, 2005 was based on the grant date fair value estimated in accordance with SFAS 123R. We recognize compensation expense for stock option awards granted on a straight-line basis over the requisite service period of the award. See Explanatory Note and Note 3, "Restatement of Consolidated Financial Statements," of the Notes to Consolidated Financial Statements regarding our determination of measurement dates for certain stock option grants.

Impairment of Long Lived Assets. Our long-lived assets consist primarily of property and equipment, which are carried at historical cost. Only in situations where there are specific events that may change the estimated remaining useful life of such assets are the value of these assets subject to impairment. Any future impairment would not impact cash flow but would result in a charge to our statement of operations.

Restructuring Charges. In the fourth quarter of 2006, we recorded a charge of approximately $0.9 million for the early termination of a facility lease, primarily representing future payments required by us under the lease termination agreement. In prior years, we recorded significant charges to operations in connection with our restructuring programs. The related reserves reflect estimates, primarily relating to facility exit costs. We reassess the reserve requirements to complete each restructuring program at the end of each reporting period. Actual experience may be different from these estimates. In 2006, 2005 and 2004, we took an additional charge of $0.4 million, $0.2 million and $0.2 million, respectively, relating to our prior restructuring charges as a result of a change in estimates relating to our future sublease assumptions.

Income Taxes. We have net deferred tax assets related to net operating loss carryforwards, that expire at various dates through 2025 and other tax temporary differences. Significant judgment is required in determining our provision for income taxes, the amount of deferred tax assets and liabilities and the valuation allowance required to offset against our net deferred tax assets. Factors such as future reversals of deferred tax assets and liabilities, projected future taxable income, changes in enacted tax rates and the period over which our deferred tax assets will be recoverable are considered in making these determinations. We evaluate the realizability of our deferred tax assets quarterly and we may reverse a portion, or all of our valuation allowance against our net deferred tax asset in future periods. If this occurs, a tax benefit would be recorded for financial reporting purposes. Our deferred tax asset is subject to a 100% valuation allowance as of December 31, 2006 and 2005.

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.

	Year Ended December 31,		
	2006	2005	2004
Net revenue	100.0%	100.0%	100.0%
Costs and operating expenses:			
Data communications and telecommunications	87.6	87.2	85.4
Research and development	2.6	3.3	5.3
Selling and marketing	3.2	3.0	3.5
General and administrative	4.9	4.0	5.0
Depreciation and amortization	1.4	1.7	4.0
Write-off of leasehold improvements	0.2	—	—
Restructuring costs	0.2	0.1	0.1
Merger related expenses	0.6	—	—
Total costs and operating expenses	100.8	99.3	103.3
Income (loss) from operations	(0.8)	0.7	(3.3)
Interest income	0.4	0.3	0.1
Interest expense	(0.1)	(0.7)	(1.6)
Other expenses, net	(0.0)	(0.1)	(0.0)
Loss on long-term non-marketable security	—	—	(1.9)
Foreign exchange (loss) gain	0.1	(0.2)	0.1
Debt conversion premium and transaction costs	—	(0.5)	—
Debt refinancing charges	—	—	(1.0)
Loss before income taxes from continuing operations	(0.4)	(0.5)	(7.6)
Foreign income tax expense	(0.0)	(0.0)	(0.0)
Loss from continuing operations	(0.4)	(0.5)	(7.6)
Income from discontinued operations	—	—	0.7
Net loss	(0.4)%	(0.5)%	(6.9)%

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Net revenue. Our primary source of revenue is the fees that we charge customers for completing voice and fax calls over our network and revenues from the sale of our prepaid calling services. Our VoIP Trading revenue is dependent on the volume of voice and fax traffic carried over the network, which is measured in minutes. 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. 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.

Our total revenue increased by $125.6 million, or 33%, to $511.1 million for 2006 from $385.5 million for 2005. Traffic carried over our network increased to 11.1 billion minutes for 2006 from 7.8 billion minutes for 2005. Our average revenue per minute was 4.6 cents per minute in 2006 compared to 5.0 cents per minute in 2005. The lower average revenue per minute in 2006 primarily reflected the growth in our

Retail business, which typically has lower average revenue per minute than our Trading business. Trading revenue increased $104.0 million, or 33%, to $416.6 million in 2006 compared to $312.6 million in 2005. The increase in Trading revenue in 2006 was, in part, a result of adding approximately 150 new Trading customers during the year. We ended 2006 with approximately 50 consumer VoIP customers, including two industry leaders, and achieved significant year-to-year revenue growth in this fast growing market. Retail revenue increased $21.6 million, or 30%, to $94.5 million compared to $72.9 million in 2005. This increase reflects the growth we have achieved with our retail prepaid calling card services, which we introduced in late 2003. During 2006, we continued to introduce a significant number of new calling card brands and expand our distribution network. Revenue from our Pingo calling services, part of our Retail services, which we launched in September 2004, was not material in 2006 or 2005.

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 to terminate voice and fax calls received from our network. Terminating costs are negotiated with the local service provider. Should competition cause a decrease in the prices we charge our customers, our contracts, in some cases, provide us with the flexibility to renegotiate the per-minute termination fees to mitigate the impact on our profit margins. Circuit costs include charges for Internet access at our Internet central offices, fees for connections between our Internet central offices and our customers and/or service provider partners, facilities charges for overseas Internet access and phone lines to the primary telecommunications carriers in particular countries, and charges for the limited number of dedicated international private line circuits we use. For our Retail calling services, these costs also include the cost of local and toll free access charges.

Data communications and telecommunications costs increased by $111.5 million, or 33%, to $447.7 million for 2006 from $336.2 million for 2005. Data communications and telecommunications costs were $367.0 million and $80.7 million for our Trading and Retail business segments in 2006, respectively, compared to $275.4 million and $60.8 million in 2005, respectively. The increase in data communications and telecommunications costs reflects the increase in revenue and traffic, as discussed above. The largest component of these costs, termination costs, increased to $439.7 million for 2006 from $329.4 million for 2005 while circuit costs increased to $8.0 million for 2006 from $6.8 million in 2005. Our average cost per minute was 4.0 cents per minute in 2006 compared to 4.3 cents per minute in 2005. As a percentage of net revenues, data communications and telecommunications costs increased to 87.6% for 2006 from 87.2% in 2005.

Gross profit. Total gross profit (net revenue less data communications and telecommunications costs) was $63.4 million, or 12.4% of total net revenue in 2006, compared to $49.3 million, or 12.8% of total net revenue in 2005. Trading gross profit was $49.6 million, or 11.9% of Trading revenue in 2006, compared to $37.2 million, or 11.9% of Trading revenue in 2005. Retail gross profit was $13.8 million, or 14.6% of Retail revenue in 2006, compared to $12.1 million, or 16.6% of Retail revenue in 2005. In Q3 of 2006, we disengaged with one of our largest prepaid calling card distributors due to delinquent payments. The prepaid cards we had sold through this distributor were primarily established brands and carried higher than average margins. As a result, the disengagement from this distributor had an adverse effect on our Retail revenue and margins in the second half of 2006.

On June 30, 2006, the Federal Communications Commission ("FCC") issued an order requiring providers of prepaid calling cards that utilize IP to contribute to the Universal Service Fund ("USF") and pay access charges and other regulatory fees both in the future and for some prior period of time. We have filed an appeal of the retroactive aspect of the FCC Order with the United States Court of Appeals in Washington, D.C. As of December 31, 2006, we estimate that the maximum potential retroactive USF charge relating to our Retail business prior to the third quarter of the year ended December 31, 2006 would be approximately $2.6 million. As the amount of retroactive fees are not probable of being incurred, no amounts have been accrued as of December 31, 2006. Retail gross profit was reduced by $0.8 million in the second half of 2006 for USF and other regulatory fees associated with our Retail business as a result of the FCC Order.

Research and development expenses. Research and development expenses include the expenses associated with developing, operating, supporting and expanding our international and domestic network, expenses for improving and operating our global network operations centers, salaries, and payroll taxes and benefits paid for employees directly involved in the development and operation of our global network operations centers and the rest of our network. Also included in this category are research and development expenses that consist primarily of expenses incurred in enhancing, developing, updating and supporting our network and our proprietary software applications.

Research and development expenses increased $0.9 million to $13.5 million for 2006 from $12.6 million for 2005. The increase in research and development expenses is primarily due to higher expenditures related to the support of The iBasis Network. Stock-based compensation included in research and development expenses was $0.5 million in 2006 and was primarily the result of the adoption of SFAS 123R, compared to $0.01 million in 2005. As a percentage of net revenue, research and development expenses decreased to 2.6% for 2006 from 3.3% for 2005.

Selling and marketing expenses. Selling and marketing expenses increased by $4.6 million, to $16.3 million in 2006, from $11.7 million in 2005. The increase in expenses primarily relates to additional investments we have made in sales and marketing, primarily to support our expanding Retail business, including an increase in advertising and marketing expenditures of $1.4 million in 2006 over 2005. Stock-based compensation included in selling and marketing expenses was $0.4 million in 2006 and was primarily the result of the adoption of SFAS 123R, compared to $0.1 million in 2005. As a percentage of net revenue, selling and marketing expenses increased to 3.2% for 2006 from 3.0% for 2005.

General and administrative expenses. General and administrative expenses include salary, payroll tax and benefit expenses and related costs for general corporate functions, including executive management, finance and administration, legal and regulatory, facilities, information technology and human resources.

General and administrative expenses increased by $9.6 million to $25.1 million for 2006 from $15.5 million for 2005. We increased our allowance for doubtful accounts by $3.8 million in 2006, including $1.3 million to cover amounts due from a prepaid calling card distributor we disengaged from doing business with in Q3 of 2006 due to delinquent payments. In 2005, we increased our allowance for doubtful accounts by $0.8 million. The increase to our allowance for doubtful accounts in 2006 relates primarily to specific customer accounts which we believe may not be collectible. We incurred $2.3 million in costs in 2006 relating to the investigation of our stock option granting practices, which primarily consisted of legal and accounting fees. Stock-based compensation included in general and administrative expenses was $0.8 million in 2006 and was primarily the result of the adoption of SFAS 123R, compared to $0.1 million in 2005. In addition, general and administrative expenses in 2006 include $0.2 million for the fair value of a warrant issued as partial payment for investment banking advisory services. As a percentage of net revenue, general and administrative expenses were 4.9% for 2006 and 4.0% for 2005.

Depreciation and amortization expenses. Depreciation and amortization expenses increased by $0.6 million to $7.1 million for 2006 from $6.5 million for 2005. As a percentage of net revenue, depreciation and amortization expenses decreased to 1.4% for 2006 from 1.7% for 2005.

Write-off of leasehold improvements and lease termination costs. In October 2006, we negotiated the early termination of leased space for one of our locations in New York City which we no longer needed. We had begun the process of negotiation with our landlord during Q3 and finalized an agreement to terminate the lease on this space in Q4 of 2006. As a result of our plan to terminate this lease, we took a non-cash charge of $1.0 million for the write-off of the carrying value of leasehold improvements in 2006.

Restructuring costs. In the fourth quarter of 2006, we took a charge of $0.9 million relating to our early termination of leased space for one of our locations in New York City. Under the lease termination agreement, we will have future monthly payment obligations totaling approximately $1.1 million through February 2011, the original lease termination date. The charge of $0.9 million consisted of our future payment obligations of $1.1 million, net of a $0.2 million reversal in a deferred rent liability arising from the difference between cumulative rental payments made under the lease agreement and rental expense recorded in our financial statements on a straight-line basis. As a result of this early lease termination, we will achieve approximately $1.2 million in future cash savings through February 2011, which represents the amount we would have paid under our original lease obligation less our future payment obligation as a result of our lease termination.

In addition, we took charges of $0.4 million and $0.2 million in 2006 and 2005, respectively, for a change in estimate relating to our sublease assumptions associated with our prior restructuring charges.

Merger related expenses. Merger related expenses of $3.0 million relate to transaction costs incurred in 2006 for the pending proposed transaction with KPN. These transaction costs consist primarily of investment banking advisory services, legal and accounting fees. These costs have been expensed as iBasis is not considered the accounting acquirer and the transaction will be accounted for as a reverse acquisition.

Interest income. Interest income was $1.9 million for 2006, compared to $1.1 million in 2005. This increase reflects a combination of higher short-term interest rates and the income earned on higher average cash and short-term investment balances in 2006 compared to 2005.

Interest expense. Interest expense decreased $2.3 million in 2006 to $0.3 million, from $2.6 million in 2005, as a result of the conversion of our 6¾% Convertible Subordinated Notes due June 2009 and 8% Secured Convertible Notes due June 2007 to common stock between June and September 2005. Interest expense in 2006 primarily consists of interest on capital equipment leases.

Other expenses, net. Other expenses, net were $0.2 million and $0.3 million in 2006 and 2005, respectively, and relate mostly to state excise, use and franchise taxes.

Foreign exchange loss (gain), net. Foreign exchange gain was $0.4 million in 2006, compared to a loss of $0.9 million in 2005. The foreign exchange gain in 2006 primarily reflects the effect of a stronger Euro relative to the U.S. dollar on our Euro-denominated accounts receivable and the foreign exchange loss in 2005 primarily reflects the effect of a weaker Euro relative to the U.S. dollar in 2005 on our Euro-denominated accounts receivable.

Debt conversion premium and transaction costs. Debt conversion premium and transaction costs of $2.0 million in 2005 reflects debt conversion premium payments made of $1.9 million to certain noteholders in June and July 2005 in negotiated agreements to encourage early conversion of $29.0 of our 8% Secured Convertible Notes due June 2007 and $2.0 million of our 6¾% Convertible Subordinated Notes due June 2009. Of the total payment, $1.7 million was paid in cash and the balance was paid in the form of 14,579 shares of our common stock with a fair value of $115,000. In addition, transactions costs were approximately $120,000 and consisted of investment banking and legal fees.

Income taxes. In 2006 we utilized approximately $3.2 million in net operating loss carry-forwards to offset taxable income. We provided a full valuation allowance against our remaining net deferred tax assets at December 31, 2006. We did not record an income tax benefit for the tax losses associated with our operations in 2005, as we believe that it is more likely than not that these benefits will not be realized. Foreign income tax expense on the earnings of our foreign subsidiaries was $37,000 and $93,000 in 2006 and 2005, respectively.

Net loss. Net loss was $2.2 million, or $(0.07) per share, in 2006 compared to a net loss of $2.0 million, or $(0.08) per share, in 2005. Net loss of $2.2 million in 2006 includes $3.0 million in merger related expenses, $2.3 million in expenses related to the investigation of our past option granting practices, and $1.9 million in charges related to the early termination of a leased facility. The net loss of $2.0 million in 2005 included $2.0 million in debt conversion premiums and transaction costs.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Net revenue. Our total net revenue increased by $121.8 million, or 46%, to $385.5 million for 2005 from $263.7 million for 2004. Traffic carried over our network increased to 7.8 billion minutes for 2005 from 4.9 billion minutes for 2004. Our average revenue per minute was 5.0 cents per minute in 2005 compared to 5.4 cents per minute in 2004. The lower average revenue per minute in 2005 primarily reflected a proportionately higher mix of lower priced traffic. Trading revenue increased $87.3 million, or 39%, to $312.6 million in 2005 compared to $225.3 million in 2004. The increase in Trading revenue in 2005 was, in part, a result of adding approximately 100 new Trading customers during the year. We ended 2005 with approximately 30 consumer VoIP customers, including two industry leaders, and achieved significant year-to-year revenue growth in this market. Retail revenue increased $34.5 million to $72.9 million, or nearly double 2004 revenue of $38.4 million. This increase reflects the growth we have achieved with our retail prepaid calling card services, which we introduced in late 2003. During 2005, we introduced a significant number of new calling card brands and expanded our distribution network, particularly in southern California. Revenue from our Pingo calling services, part of our Retail services, which we launched in September 2004, was not material in 2005 or 2004.

Data communications and telecommunications costs. Data communications and telecommunications costs increased by $111.0 million, or 49%, to $336.2 million for 2005 from $225.2 million for 2004. Data communications and telecommunications costs were $276.4 million and $60.8 million for our Trading and Retail business segments in 2005, respectively, compared to $192.6 million and $32.6 million in 2004, respectively. The increase in data communications and telecommunications costs primarily reflects the increase in revenue and traffic, as discussed above. The largest component of these costs, termination costs, increased to $329.4 million for 2005 from $219.1 million for 2004 while circuit costs increased slightly to $6.8 million for 2005 from $6.1 million in 2004. As a percentage of net revenues, data communications and telecommunications costs increased to 87.2% for 2005 from 85.4% in 2004.

Gross profit. Total gross profit (net revenue less data communications and telecommunications costs) declined to 12.8% of total net revenue in 2005, compared to 14.6% of total net revenue in 2004. Trading gross margin was 11.9% of Trading revenue in 2005, compared to 14.5% in 2004. The lower Trading gross margin was primarily due to lower rates on certain U.S.-originated and China-originated traffic in 2005. Retail gross margin was 16.6% of Retail revenue in 2005, compared to 14.9% in 2004.

Research and development expenses. Research and development expenses decreased $1.4 million to $12.6 million for 2005 from $14.0 million for 2004. The decrease in research and development expenses is due to lower expenditures related to the support of The iBasis Network. As a percentage of net revenue, research and development expenses decreased to 3.3% for 2005 from 5.3% for 2004.

Selling and marketing expenses. Selling and marketing expenses increased by $2.3 million, to $11.7 million in 2005, from $9.4 million in 2004. The increase in expenses primarily relates to additional investments we have made in sales and marketing, primarily to support our expanding Retail business, including increasing advertising and marketing expenditures by $0.6 million. As a percentage of net revenue, selling and marketing expenses decreased to 3.0% for 2005 from 3.5% for 2004.

General and administrative expenses. General and administrative expenses increased by $2.3 million to $15.5 million for 2005 from $13.2 million for 2004. Increases to the allowance for doubtful accounts were $0.9 million in 2005 compared to $0.3 million in 2004. In addition, incentive compensation was $0.3 million and professional fees increased by $0.8 million, which related largely to compliance with the internal control provisions under Section 404 of the Sarbanes-Oxley Act. As a percentage of net revenue, general and administrative expenses were 4.0% for 2005 and 4.8% for 2004.

Restructuring costs. In 2005 and 2004, we took charges of $0.2 million for a change in estimate relating to our sublease assumptions associated with our prior restructuring charges.

Depreciation and amortization expenses. Depreciation and amortization expenses decreased by $3.9 million to $6.5 million for 2005 from $10.4 million for 2004. This decrease was primarily due to the end of the depreciable life of certain networking equipment and computer software. As a percentage of net revenue, depreciation and amortization expenses decreased to 1.7% for 2005 from 4.0% for 2004.

Interest income. Interest income was $1.1 million for 2005, compared to $0.2 million in 2004. This increase primarily reflects the income earned on higher average cash and short-term investment balances in 2005 compared to 2004.

Interest expense. Interest expense decreased $1.6 million in 2005 to $2.6 million, from $4.2 million in 2004, as a result of the conversion of our 6¾% Convertible Subordinated Notes due June 2009 and 8% Secured Convertible Notes due June 2007 to common stock between June and September 2005. In addition, interest expense also includes interest on capital leases of $0.3 million and $0.5 million in 2005 and 2004, respectively.

Other expenses, net. Other expenses, net were $0.4 million and $0.2 million in 2005 and 2004, respectively, and relate mostly to state excise, use and franchise taxes.

Foreign exchange loss(gain), net. Foreign exchange loss was $0.9 million in 2005, compared to a gain of $0.3 million in 2004. The increase in foreign exchange loss primarily reflects the effect of the weakening Euro relative to the U.S. dollar on our Euro-denominated accounts receivable. We began separately reporting foreign exchange gain and losses in 2005 as they have become material. We have reclassified prior year amounts to conform to the current year presentation.

Loss on long-term non-marketable security. In the first quarter of 2004, we determined that our equity investment in a privately-held company had been other than temporarily impaired, and, as a result, recorded a non-cash $5.0 million charge. Our decision was based on our evaluation of the privately-held company's current cash position and recent operating results, as well as the perceived inability of that company to obtain additional financing at a level, and in a timely manner, to support its continued operations.

Debt conversion premium and transaction costs. Debt conversion premium and transaction costs of $2.0 million reflects debt conversion premium payments made of $1.9 million to certain noteholders in June and July 2005 in negotiated agreements to encourage early conversion of $29.0 of our 8% Secured Convertible Notes due June 2007 and $2.0 million of our 6¾% Convertible Subordinated Notes due June 2009. Of the total payment, $1.7 million was paid in cash and the balance was paid in the form of 14,579 shares of our common stock with a fair value of $115,000. In addition, transactions costs were approximately $120,000 and consisted of investment banking and legal fees.

Refinancing transaction costs. Transaction costs relating to the refinancing of our debt in June 2004 were $2.2 million. These costs consisted primarily of investment banking services, legal and audit fees.

Refinancing related interest expense. We issued warrants to purchase a total of 1.7 million shares of our common stock, at $5.55 per share, to the holders of the 11½% Senior Secured Notes due January 2005 as partial consideration for the prepayment of these notes in June 2004. The fair value of $2.1 million for these warrants has been charged to operations as additional interest expense. Future interest on the 11½% Senior Secured Notes due January 2005 of $1.6 million, that had originally been charged to the gain on bond exchanges in 2003 and was not paid as a result of the prepayment of these notes, was recorded as a reduction to the additional interest expense associated with the refinancing. As a result, refinancing related interest expense, net was $0.5 million in 2004.

Income taxes. We have not recorded an income tax benefit for the tax losses associated with our operations in 2005 and 2004, as we believe that it is more likely than not that these benefits will not be realized. Foreign income tax expense on the earnings of our foreign subsidiaries was $93,000 and $50,000 in 2005 and 2004, respectively.

Income from discontinued operations. We had no income or loss from discontinued operations in 2005. Income from discontinued operations of $1.9 million in 2004 relates to the expiration of certain contingent obligations associated with the sale of our former Speech Solutions Business in 2002.

Net loss. Loss from continuing operations was $2.0 million in 2005 compared to a loss of $20.2 million in 2004.

Excluding debt conversion premium and transaction costs of $2.0 million, loss from continuing operations was $0.1 million in 2005. Excluding debt refinancing charges of $2.6 million and the loss on a long-term non-marketable security of $5.0 million, the loss from continuing operations in 2004 was $12.5 million. The improved profitability of $12.1 million in 2005 compared to 2004, excluding debt conversion premium and transactions costs, refinancing charges and loss on a long-term non-marketable security, relates to the proportionately lower level of costs and operating expenses on the higher level of revenues year-to-year.

Liquidity and Capital Resources

Our principal capital and liquidity needs historically have related to the development of our network infrastructure, our sales and marketing activities, research and development expenses, and general capital needs. Our working capital needs have been met, in large part, from the net proceeds of public and private offerings of common stock and issuances of convertible debt. In addition, we have also met our capital needs through capital equipment leases and other equipment financings.

Net cash provided by operating activities was $23.4 million in 2006, compared to net cash provided by operating activities of $12.2 million in 2005 and net cash used in operating activities of $7.2 million in 2004. Cash provided by operating activities in 2006 was the result of the loss of $2.2 million offset by non-cash charges of $14.1million, and an increase in accounts payable, accrued expenses and deferred revenue of $35.6 million, partially offset by an increase in accounts receivable of $21.7 million. The increases in accounts receivable and accounts payable relate primarily to the growth in revenue and traffic in 2006 over 2005. Accounts receivable days sales outstanding were 43 days at December 31, 2006 compared to 41 days at December 31, 2005. Cash provided by operating activities in 2005 of $12.2 million was a result of the loss of $2.0 million, offset by non-cash charges of $8.2 million, and an increase in accounts payable, accrued expenses and deferred revenue of $20.7 million, partially offset by an increase in accounts receivable of $14.2 million. Cash used in operating activities in 2004 of $7.2 million is a result of the loss from continuing operations of $20.2 million, partially offset by non-cash charges of $18.6 million. In addition, the increase in accounts receivable of $12.5 million was partially offset by an increase in accounts payable, accrued expenses and deferred revenue of $8.0 million.

Net cash used in investing activities in 2006 of $12.1 million included $10.5 million used for capital expenditures and net purchases of $1.6 million of short-term investments. Our short-term investments are classified as available-for-sale and consist of securities that are readily convertible into cash, including government securities and commercial paper, with original maturities at the date of acquisition ranging from 90 days to one year. At December 31, 2006, $18.5 million of securities with maturities of less than one year were classified as short-term investments. Net cash used in investing activities in 2005 of $2.4 million included $3.4 million used for capital expenditures, partially offset by net maturities of short-term investments of $1.0 million. Net cash used in investing activities in 2004 of $18.7 million consisted of $3.3 million used for capital expenditures and $17.9 million in net purchases of short-term investments. In

2004, we also received proceeds from an earn-out receivable and escrow payment of $1.0 million and $1.5 million, respectively, relating to the sale of our former Speech Solutions Business.

Net cash used in financing activities was $3.3 million in 2006 and included $2.3 million used to purchase shares of our common stock under our stock repurchase program and $1.6 million in capital equipment lease payments, partially offset by $0.6 million in proceeds from stock option exercises. In February of 2006, we expanded our previously announced program to allow for the purchase of up to a total of $15.0 million of our common stock. In the first quarter of 2006, we purchased 0.4 million shares of our common stock at a cost of $2.3 million, leaving $10.8 million available for future purchases. Since March 2006, we have not made any purchases of our common stock and we have no current plans for any further purchases under this program. Net cash used in financing activities was $3.2 million in 2005 and consisted of debt conversion premium payments and transaction costs of $1.9 million, the redemption of the remaining $0.9 million of 5¾% Convertible Subordinated Notes on their maturity date in March 2005 and capital lease payments of $1.2 million. During 2005, we received proceeds of $2.6 million from warrant and stock option exercises. In the fourth quarter of 2005, we repurchased 0.3 million shares of our common stock at a cost of $1.9 million under our stock repurchase program announced in October 2005 to purchase up to $5.0 million of our common stock.

During 2005, we completed the process of eliminating our long-term bond debt through a series of debt conversion transactions. These transactions have resulted in interest savings on an annualized basis of approximately $4.7 million. In June 2005, we negotiated (i) the early conversion of $9.1 million of our 8% Secured Convertible Notes due June 2007 into 1.6 million shares of common stock at the conversion price of $5.55 per common share and (ii) the early conversion of $2.0 million of our 6¾% Convertible Subordinated Notes due June 2009 into 0.4 million shares of common stock at the conversion price of $5.55 per common share. We paid a total of $0.7 million in premiums to the noteholders to encourage the early conversion of these notes, of which $0.6 million was paid in cash and the remaining $115,000 was paid in the form of 14,579 shares of our common stock with a fair value of $0.1 million. In addition, $1.2 million of our 6¾% Convertible Subordinated Notes due June 2009 voluntarily converted into 0.2 million shares of common stock at the conversion price of $5.55 per share. In total, $12.3 million of notes were converted into 2.2 million shares of common stock.

In July 2005, we negotiated the early conversion of the remaining $19.9 million of our 8% Secured Convertible Notes due June 2007 into 3.6 million shares of common stock at the stated conversion price of $5.55 per share. We paid a total premium of $1.2 million in cash to the noteholders to encourage the early conversion of these notes. In addition, transaction costs associated with this early conversion were $0.1 million and consisted primarily of investment banking fees.

From mid-August 2005 through early September 2005, the remaining $32.6 million of our 6¾% Convertible Subordinated Notes due June 2009 were converted to shares of our common stock at the stated conversion price of $5.55 per share. In mid-August 2005, we announced our intention to redeem all of these outstanding notes for cash at the face value of the notes, plus accrued interest, with a planned redemption date of September 6, 2005. Prior to the redemption date, all of the holders elected to convert their notes to common stock at the stated conversion price of $5.55 per share.

Net cash provided by financing activities was $29.5 million in 2004. In June 2004, we completed a refinancing of our outstanding debt obligations. As part of the refinancing, we completed an exchange offer, pursuant to which $37.3 million of our outstanding 5¾% Convertible Subordinated Notes due March 2005, representing approximately 98% of the total amount of these notes then outstanding, were tendered for the same principal amount of new 6¾% Convertible Subordinated Notes due June 2009. Approximately $0.9 million of the 5¾% Convertible Subordinated Notes due March 2005 remained outstanding after the exchange offer. Simultaneously with the exchange offer, we prepaid all $25.2 million of our existing 11½% Senior Secured Notes due January 2005 for cash equal to the principal amount plus accrued but unpaid interest and the issuance of warrants exercisable for an aggregate of 1.7 million shares of our common stock at \$5.55 per share. We issued \$29.0 million of new 8% Secured Convertible Notes due June 2007 of which \$25.2 million was used to prepay the 11½% Senior Secured Notes due January 2005. Cash paid for transactions costs associated with the debt refinancing were \$2.0 million. During the second half of 2004, holders of \$1.3 million of 6¾% Convertible Subordinated Notes due June 2009 voluntarily converted their notes into 0.2 million shares of common stock at the conversion price of \$5.55 per share. In 2005, the remaining 6¾% Convertible Subordinated Notes due June 2009 and the 8% Secured Convertible Notes due June 2007 were converted into shares of our common stock at \$5.55 per share, as described above.

In September 2004, we completed a private equity placement of 5.0 million shares of our common stock at \$6.30 per share, for total gross proceeds of \$31.5 million, to a group of institutional and accredited investors. Investment banking fees and other costs of the transaction were \$1.3 million, resulting in net proceeds to us from the private equity placement of \$30.2 million. The net proceeds from the private equity placement were used for working capital requirements, capital asset purchases and general corporate purposes. In addition in 2004, we received proceeds of \$2.0 million from the exercise of warrants and stock options, made payments on capital leases of \$2.2 million and paid down our bank borrowings of \$2.3 million.

In May 2007, we amended certain financial covenants and extended the maturity date of our revolving line of credit with our bank from May 31, 2007 until July 30, 2007. The \$15.0 million revolving line of credit bears interest at the bank's prime rate plus ½% and is collateralized by substantially all of our assets. Borrowings under the line may also be used for letters of credit and foreign exchange contracts. The revolving line of credit requires us to comply with various non-financial and financial covenants, including minimum profitability and liquidity and requires us to maintain a minimum cash balance of \$15.0 million with the bank, or be subject to certain additional fees. We have received waivers of non-compliance of certain financial covenants from our bank for Q3 and Q4 of 2006. At December 31, 2006 and 2005, we had no borrowings under our bank line of credit. At December 31, 2006, we had \$2.7 million in letters of credit outstanding under our bank line of credit.

During 2005 and 2004, we financed \$3.2 million and \$1.8 million of capital expenditures, respectively, with lease financing. The majority of the capital lease obligations have a three year term.

On May 2, 2006, after receiving shareholder approval, we affected a one-for-three reverse stock split of our issued and outstanding shares of common stock. On June 21, 2006, our common stock resumed trading on The Nasdaq Global Market under the stock symbol "IBAS", after we met the requirements for relisting on The Nasdaq Global Market.

On June 30, 2006, the Federal Communications Commission ("FCC") issued an order requiring providers of prepaid calling cards that utilize IP to contribute to the Universal Service Fund ("USF") and pay access charges and other regulatory fees both in the future and for some prior period of time. In connection with our Retail business, we plan to absorb or pass along such future fees, to the extent permitted by law, which, based on current traffic mix, equal approximately 1.8% of revenue. We have filed an appeal of the retroactive aspect of the FCC Order with the United States Court of Appeals in Washington, D.C. In October 2006, we filed a motion to stay that aspect of the FCC Order pending the outcome of the appeal. On November 1, 2006, the Court deferred ruling on the stay request pending the FCC's ruling on a similar stay motion pending before the agency. The agency denied the stay request on March 29, 2007. As of December 31, 2006, we estimate that the maximum potential retroactive USF charge relating to our Retail business prior to the third quarter of the year ended December 31, 2006 would be approximately \$2.6 million. If we are not successful with our appeal of the retroactive aspect of the FCC Order and are required to pay USF and other fees on a retroactive basis, we do not believe we would be able to recover these fees from our customers. As such, we would have to fund these fees up to the estimated maximum retroactive amount of $2.6 million. As the amount of retroactive fees are not probable of being incurred, no amounts have been accrued as of December 31, 2006.

In 2006 we utilized approximately $3.2 million in net operating loss carry-forwards to offset taxable income. At December 31, 2006, we had a deferred tax asset of approximately $125.1 million representing net operating loss and tax credit carry-forwards available to us to offset future potential taxable income. We have provided a full valuation allowance against all of our deferred tax assets as of December 31, 2006.

We have incurred substantial expenses for legal, accounting, tax and other professional services in connection with the Special Committee investigation, our internal review of our historical financial statements, the preparation of the restated financial statements and the SEC investigation. These expenses were approximately $2.3 million in 2006 and we have continued to incur significant expenses in connection with these matters since December 31, 2006.

We anticipate that the December 31, 2006 balance of $54.1 million in cash, cash equivalents and short-term investments, together with expected net cash flow generated from operations, will be sufficient to fund our operations and capital asset expenditures for at least the next twelve months. We expect capital asset expenditures to be between $15 million and $20 million in 2007.

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, 2006:

		Payment Due Dates				
	Total	Less than 1 Year	1 to 2 Years	2 to 3 Years	3 to 5 Years	After 5 Years
			(In thousands)			
Capital lease obligations	$ 2,363	$ 1,568	$ 795	$ —	$ —	$ —
Operating leases	9,293	2,442	1,894	1,688	1,178	2,091
Total	$ 11,656	$ 4,010	$ 2,689	$ 1,688	$ 1,178	$ 2,091

New Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. In particular, the Interpretation requires that a tax benefit related to a given tax position be reflected in the financial statements only if it is more likely than not that it would be sustained on its technical merits in the event of a tax audit. FIN 48 will become effective for us on January 1, 2007. The adoption of FIN 48 will not have a material effect on our financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," (" SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but may change current practice for some entities. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. We do not believe that the adoption of SAB 157 will have a material effect on our financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159), which provides entities with the option to measure certain financial instruments and other items at fair value, whereas those items are not currently required to be measured at fair value. SFAS 159 will be effective for us on January 1, 2008. We are currently evaluating the impact the adoption of SFAS 159 will have on our financial position, results of operations or cash flows.

In September 2006, the Staff of the SEC issued Staff Accounting Bulletin No. 108, "*Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*" ("SAB 108"). SAB 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of determining whether the current year's financial statements are materially misstated. SAB 108 was effective for fiscal years ended December 31, 2006. The adoption of SAB 108 did not have any material effect on our financial position, results of operations or 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. To date, we have not engaged in trading market risk sensitive instruments or purchasing hedging instruments, whether interest rate, foreign currency exchange, commodity price or equity price risk. We have not purchased options or entered into swaps or forward or futures contracts.

Our investments in commercial paper and debt instruments are subject to interest rate risk, but due to the short-term nature of these investments, interest rates would not have a material impact on their value at December 31, 2006. 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. We had no borrowings under our bank line of credit at December 31, 2006. 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. A 10% change in interest rates would not have a material impact on interest expense associated with our bank line of credit.

Although we conduct our business in various regions of the world, most of our revenues and costs are denominated in U.S. dollars with the remaining being primarily denominated in Euros or British pounds. Thus, we are exposed to foreign currency exchange rate fluctuations as the financial results and balances of our foreign subsidiaries 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. Accordingly, if the dollar weakens relative to foreign currencies, particularly the Euro or British Pound, our foreign currency-based denominated revenues and expenses would increase when stated in U.S. Dollars. Conversely, if the dollar strengthens, our foreign currency denominated revenues and expenses would decrease. Based on our net revenue for the year ended December 31, 2006, if the U.S. dollar had weakened against the Euro and British Pound by 10%, our net revenue would have increased approximately 3%. Conversely, based on our net revenue for the year ended December 31, 2006, if the U.S. dollar had strengthened against the Euro and British Pound by 10%, our net revenue would have decreased by approximately 3%. The impact of a 10% change in the exchange rate between the U.S. dollar and the Euro or British Pound would not have a material effect on our foreign currency denominated operating expenses.

Item 8. ***Financial Statements and Supplementary Data***

Index to Consolidated Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of iBasis, Inc.:

We have audited the accompanying consolidated balance sheets of iBasis, Inc. and subsidiaries (the "Company") as of December 31, 2006 and December 31, 2005, and the related consolidated statements of operations, shareholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2006. 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 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2006 and December 31, 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123 (R), *"Share-Based Payment,"* on January 1, 2006.

As discussed in Note 3 to the consolidated financial statements, the accompanying 2005 and 2004 consolidated financial statements have been restated.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 11, 2007, expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP

Boston, Massachusetts
June 11, 2007

iBasis, Inc.
Consolidated Balance Sheets

	December 31, 2006	December 31, 2005 (as restated)(1)
	(In thousands, except per share data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 35,525	$ 27,478
Short-term marketable investments	18,546	16,936
Accounts receivable, net of allowance for doubtful accounts of $3,803 and $2,507, respectively	65,135	47,321
Prepaid expenses and other current assets	4,190	2,676
Total current assets	123,396	94,411
Property and equipment, at cost:		
Network equipment	38,696	53,434
Equipment under capital lease	4,917	4,917
Computer software	9,837	10,353
Leasehold improvements	4,867	6,697
Furniture and fixtures	848	1,049
	59,165	76,450
Less—Accumulated depreciation and amortization	(45,307)	(65,033)
	13,858	11,417
Other assets	410	323
	$ 137,664	$ 106,151
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 48,638	$ 27,796
Accrued expenses	37,302	24,705
Deferred revenue	10,709	9,517
Current portion of long-term debt	1,462	1,598
Total current liabilities	98,111	63,616
Long-term debt, net of current portion	755	2,216
Other long-term liabilities	1,417	916
Commitments and contingencies (Note 12)		
Stockholders' equity (deficit):	—	—
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—34,286 and 34,112 shares, respectively;	34	34
Treasury stock, 1,069 and 691 shares, respectively, at cost	(4,358)	(2,091)
Additional paid-in capital	485,940	483,771
Deferred compensation	—	(250)
Accumulated other comprehensive income (loss)	3	(17)
Accumulated deficit	(444,238)	(442,044)
Total stockholders' equity	37,381	39,403
	$ 137,664	$ 106,151

(1) See Note 3, "Restatement of Consolidated Financial Statements," of the Notes to Consolidated Financial Statements.

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

iBasis, Inc.
Consolidated Statements of Operations

	Years Ended December 31,		
	2006	2005 (as restated)(1)	2004 (as restated)(1)
	(In thousands, except per share data)		
Net revenue	$511,083	$385,485	$263,678
Costs and operating expenses:			
Data communications and telecommunications (excluding depreciation and amortization)	447,697	336,152	225,169
Research and development	13,498	12,568	14,013
Selling and marketing	16,347	11,712	9,351
General and administrative	25,062	15,543	13,162
Depreciation and amortization	7,055	6,507	10,437
Write-off of leasehold improvements	1,047	—	—
Restructuring costs	1,272	218	165
Merger related expenses	2,996	—	—
Total costs and operating expenses	514,974	382,700	272,297
(Loss) income from operations	(3,891)	2,785	(8,619)
Interest income	1,887	1,109	218
Interest expense	(337)	(2,601)	(4,249)
Other expenses, net	(188)	(324)	(184)
Loss on long-term non-marketable security	—	—	(5,000)
Foreign exchange gain (loss)	372	(939)	339
Debt conversion premium and transaction costs	—	(1,975)	—
Debt refinancing charges:			
Transaction costs	—	—	(2,159)
Additional interest expense, net	—	—	(481)
Loss before taxes from continuing operations	(2,157)	(1,945)	(20,135)
Income tax expense	(37)	(93)	(50)
Loss from continuing operations	(2,194)	(2,038)	(20,185)
Income from discontinued operations	—	—	1,861
Net loss	$ (2,194)	$ (2,038)	$ (18,324)
Basic and diluted net loss per share:			
Loss from continuing operations	$ (0.07)	$ (0.08)	$ (1.20)
Income from discontinued operations	—	—	0.11
Net loss per share	$ (0.07)	$ (0.08)	$ (1.09)
Basic and diluted weighted average common shares outstanding	33,198	26,745	16,838

(1) See Note 3, "Restatement of Consolidated Financial Statements," of the Notes to Consolidated Financial Statements.

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

iBasis, Inc.
Consolidated Statements of Stockholders' Equity (Deficit)
(as restated)(1)

	Common Stock Number of Shares	Common Stock $0.001 Par Value	Treasury Stock Number of Shares	Treasury Stock Amount	Additional Paid-In Capital	Deferred Compensation	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity (Deficit)
	(In thousands)								
Balance, December 31, 2003 (as previously reported)	15,305	$ 15	(378)	$ (341)	$ 370,424	$ —	$ (412,206)	$ —	$ (42,108)
Adjustments to beginning stockholders' deficit in connection with restatement	—	—	—	—	9,426	(523)	(9,476)	—	(573)
Balance, December 31, 2003 (as restated)	15,305	15	(378)	(341)	379,850	(523)	(421,682)	—	(42,681)
Net loss	—	—	—	—	—	—	(18,324)	—	(18,324)
Unrealized loss on available-for-sale short-term investments	—	—	—	—	—	—	—	(12)	(12)
Total comprehensive loss									(18,336)
Gross proceeds from sale of common stock in private placement	5,000	5	—	—	31,495	—	—	—	31,500
Cash transaction costs of private placement	—	—	—	—	(1,310)	—	—	—	(1,310)
Fair value of warrant issued for investment banking services	—	—	—	—	(2,808)	—	—	—	(2,808)
Issuance of warrant for investment banking services	—	—	—	—	2,808	—	—	—	2,808
Common stock issued as partial payment of investment banking fees	37		—	—	175	—	—	—	175
Exercise of common stock options	169		—	—	455	—	—	—	455
Exercise of warrants	840	1	—	—	1,461	—	—	—	1,462
Fair value of warrants issued in debt refinancing	—	—	—	—	2,140	—	—	—	2,140
Conversion of 6 3/4% Convertible Subordinated Notes due June 2009 converted to common stock	242	1	—	—	1,340	—	—	—	1,341
Increase in deferred compensation	—	—	—	—	456	(456)	—	—	—
Amortization of deferred compensation	—	—	—	—	—	503	—	—	503
Reduction in deferred compensation for terminations	—	—	—	—	(44)	44	—	—	—
Balance, December 31, 2004	21,593	22	(378)	(341)	416,018	(432)	(440,006)	(12)	(24,751)
Net loss	—	—	—	—	—	—	(2,038)	—	(2,038)
Unrealized loss on available-for-sale short-term investments	—	—	—	—	—	—	—	(5)	(5)
Total comprehensive loss									(2,043)
Exercise of common stock options.	79	—	—	—	244	—	—	—	244
Exercise of warrants	739	1	—	—	2,421	—	—	—	2,422
Convertible Subordinated Notes due June 2009 converted to common stock	6,476	6	—	—	35,938	—	—	—	35,944
Secured Convertible Notes due June 2007 converted to common stock	5,225	5	—	—	28,995	—	—	—	29,000
Common shares issued as payment of debt conversion premium.	—	—	15	115	—	—	—	—	115
Repurchases of common stock	—	—	(328)	(1,865)	—	—	—	—	(1,865)
Increase in deferred compensation	—	—	—	—	176	(176)	—	—	—
Amortization of deferred compensation	—	—	—	—		337	—	—	337
Reduction in deferred compensation for terminations	—	—	—	—	(21)	21	—	—	—
Balance, December 31, 2005	34,112	34	(691)	(2,091)	483,771	(250)	(442,044)	(17)	39,403
Net loss	—	—	—	—	—	—	(2,194)	—	(2,194)
Unrealized gain on available-for-sale short-term investments	—	—	—	—	—	—	—	19	19
Translation adjustment	—	—	—	—	—	—	—	1	1
Total comprehensive loss									(2,174)
Exercise of common stock options	174	—	—	—	590	—	—	—	590
Fair value of warrant issued for investment advisory services	—	—	—	—	162	—	—	—	162
Repurchases of common stock	—	—	(378)	(2,267)	—	—	—	—	(2,267)
Elimination of deferred compensation					(250)	250			—
Stock-based compensation					1,667				1,667
Balance, December 31, 2006	34,286	$ 34	(1,069)	$ (4,358)	$ 485,940	$ —	$ (444,238)	$ 3	$ 37,381

(1) See Note 3, "Restatement of Consolidated Financial Statements," of the Notes to Consolidated Financial Statements.

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