

# FORM 10-Q

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended **June 30, 2010**

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934

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

**000-30061**

(Commission file No.)

**ELEPHANT TALK COMMUNICATIONS, INC.**

(Exact name of small business issuer as specified in its charter)

**CALIFORNIA**

(State or other jurisdiction of  
incorporation or organization)

**95-4557538**

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

**19103 Centre Rose Boulevard**

**Lutz, FL 33558**

**United States**

(Address of principal executive offices)

**+ 1 813 926 8920**

(Issuer's telephone number, including area code)

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

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

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

Large Accelerated filer  Accelerated filer  Non-Accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of August 13, 2010, there were 75,699,642 shares of the Company's common stock outstanding.

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**ELEPHANT TALK COMMUNICATIONS, INC.**  
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**PART I - FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

**ELEPHANT TALK COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEET**  
**(UNAUDITED)**

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 4,276,714	\$ 1,457,900
Restricted cash	188,630	192,116
Accounts receivable, net of an allowance for doubtful accounts of \$595,284 and \$764,302 at June 30, 2010 and December 31, 2009 respectively	5,716,232	5,071,293
Prepaid expenses and other current assets	2,166,298	2,657,019
<b>Total Current Assets</b>	<u>12,347,874</u>	<u>9,378,328</u>
<b>LONG TERM DEPOSITS</b>	346,746	330,946
<b>DEFERRED FINANCING COSTS</b>	2,117,067	3,033,277
<b>PROPERTY AND EQUIPMENT, NET</b>	6,829,204	7,773,862
<b>INTANGIBLE ASSETS, NET</b>	16,699,367	3,910,363
<b>GOODWILL</b>	3,046,790	--
<b>TOTAL ASSETS</b>	<u>\$ 41,387,048</u>	<u>\$ 24,426,776</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>		
<b>CURRENT LIABILITIES</b>		
Overdraft	\$ 353,904	\$ 351,589
Accounts payable and customer deposits	4,178,589	6,475,074
Deferred revenue	--	132,205
Accrued expenses and other payables	5,552,413	2,738,998
Shares to be issued	7,161,795	--
Convertible 14% loan - related party (net of discount of \$ 1,421,941 and \$0, respectively)	836,539	--
Advances from related parties	--	13,287
Loans payable	877,187	880,536
<b>Total Current Liabilities</b>	<u>18,960,427</u>	<u>10,591,689</u>
<b>LONG TERM LIABILITIES</b>		
Loan from related party	450,436	437,161
Convertible 12% secured note (net of discount of \$ 12,126,341 and \$12,333,020 respectively)	95,680	--
Warrant liabilities	28,038,455	16,626,126
Conversion feature	8,735,904	2,899,801
<b>Total Long term Liabilities</b>	<u>37,320,475</u>	<u>19,963,088</u>
<b>Total Liabilities</b>	<u>56,280,902</u>	<u>30,554,777</u>
<b>STOCKHOLDERS' EQUITY (DEFICIT)</b>		
Common stock, no par value, 250,000,000 shares authorized, 65,812,367 issued and outstanding as of June 30, 2010 compared to 53,695,984 shares issued and outstanding as of December 31, 2009	76,521,715	54,880,778
Accumulated other comprehensive income (loss)	(2,553,849)	1,136,897
Accumulated deficit	(89,030,994)	(62,335,076)
Elephant Talk Communications, Inc. Stockholders' Equity	<u>(15,063,128)</u>	<u>(6,317,401)</u>
<b>NON-CONTROLLING INTEREST</b>		
<b>Total Stockholders' Equity</b>	<u>169,274</u>	<u>189,400</u>
<b>Total Stockholders' Equity</b>	<u>(14,893,854)</u>	<u>(6,128,001)</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>	<u>\$ 41,387,048</u>	<u>\$ 24,426,776</u>

The accompanying notes are an integral part of the unaudited consolidated financial statements

**ELEPHANT TALK COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF OPERATIONS AND COMPREHENSIVE LOSS**  
(UNAUDITED)

	For the Three Months Period ended, June 30		For the Six Months Period ended, June 30	
	2010	2009	2010	2009
REVENUES	\$ 9,673,825	\$ 11,311,398	\$ 19,617,590	\$ 20,740,282
<b>COST AND OPERATING EXPENSES</b>				
Cost of service	9,005,394	10,632,204	18,379,282	19,780,001
Selling, general and administrative expenses	2,079,359	1,783,795	3,984,709	3,246,943
Non cash compensation to officers, directors and employees	2,712,756	750,406	3,253,669	1,019,866
Depreciation and amortization of intangibles assets	1,515,428	707,763	2,360,122	1,337,945
Total cost and operating expenses	<u>15,312,937</u>	<u>13,874,168</u>	<u>27,977,782</u>	<u>25,384,755</u>
LOSS FROM OPERATIONS	(5,639,112)	(2,562,770)	(8,360,192)	(4,644,473)
<b>OTHER INCOME (EXPENSE)</b>				
Interest income	32,520	12,237	65,119	22,307
Interest expense	(535,887)	(136,154)	(982,427)	(207,939)
Interest expense related to debt discount	(4,959,044)	--	(7,545,823)	--
Change in fair value of warrant liabilities & conversion feature	(2,660,727)	--	(8,748,778)	--
Amortization of deferred financing costs	(593,689)	--	(1,121,535)	--
Total other income (expense)	<u>(8,716,827)</u>	<u>(123,917)</u>	<u>(18,333,444)</u>	<u>(185,632)</u>
LOSS BEFORE PROVISION FOR INCOME TAXES	(14,355,939)	(2,686,687)	(26,693,636)	(4,830,105)
Provision for income taxes	(800)	-	(800)	(800)
NET LOSS BEFORE NONCONTROLLING INTEREST	<u>(14,356,739)</u>	<u>(2,686,687)</u>	<u>(26,694,436)</u>	<u>(4,830,905)</u>
Net (loss) income attributable to noncontrolling interest	(1,785)	(653)	(2,283)	(756)
NET LOSS	<u>(14,358,524)</u>	<u>(2,687,340)</u>	<u>(26,696,719)</u>	<u>(4,831,661)</u>
<b>OTHER COMPREHENSIVE (LOSS) INCOME</b>				
Foreign currency translation gain (loss)	(3,168,961)	470,533	(3,690,746)	(197,259)
	<u>(3,168,961)</u>	<u>470,533</u>	<u>(3,690,746)</u>	<u>(197,259)</u>
COMPREHENSIVE LOSS	<u>\$ (17,527,485)</u>	<u>\$ (2,216,807)</u>	<u>\$ (30,387,465)</u>	<u>\$ (5,028,920)</u>
Net loss per common share and equivalents - basic and diluted	<u>\$ (0.23)</u>	<u>\$ (0.05)</u>	<u>\$ (0.45)</u>	<u>\$ (0.09)</u>
Weighted average shares outstanding during the period - basic and diluted	<u>62,356,471</u>	<u>53,864,109</u>	<u>58,696,088</u>	<u>52,693,232</u>

The accompanying notes are an integral part of the unaudited consolidated financial statements

**ELEPHANT TALK COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(UNAUDITED)

	<b>For the six months period ended, June 30</b>	
	<b>2010</b>	<b>2009</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (26,696,719)	\$ (4,831,661)
<b>Adjustments to reconcile net loss to net cash used in operating activities:</b>		
Depreciation and amortization	2,360,122	1,337,945
Provision for doubtful accounts	(57,474)	(178,090)
Stock based compensation	2,876,951	868,616
Noncontrolling interest	2,283	756
Amortization of Shares issued for Consultancy	376,718	151,250
Issuance of stock	221,626	--
Exercise of warrants (cash less)	364,718	--
Exercise of convertible note (cash less)	112,443	--
Change in fair value of warrant liabilities	8,748,778	--
Amortization of deferred financing costs	1,121,535	--
Interest expense relating to debt discount and conversion feature	7,545,823	--
<b>Changes in operating assets and liabilities:</b>		
Decrease (increase) in accounts receivable	(1,342,543)	(1,704,371)
Decrease (Increase) in prepaid expenses, deposits and other assets	162,513	(158,168)
Increase (decrease) in accounts payable, proceeds from related parties and customer deposits	(1,789,851)	1,565,246
Increase (decrease) in deferred revenue	(131,835)	(1,807)
Increase (decrease) in accrued expenses and other payables	(717,070)	(112,870)
<b>Net cash used in operating activities</b>	<b>(6,841,983)</b>	<b>(3,063,154)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(1,214,286)	(1,963,245)
Restricted cash	20	18
Cash received from acquisition of subsidiary	48,577	--
Loan to third party	--	(345,895)
<b>Net cash used in investing activities</b>	<b>(1,165,689)</b>	<b>(2,309,122)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Bank overdraft	18,721	12,767
Deferred financing costs	(205,326)	--
Loan from related party QAT Bridge Loan	2,513,195	4,340,497
Loan from related party Bridge SPA	2,885,000	--
Proceeds from Private Placement Offering	6,459,800	--
Exercise of warrants (cash less)	25,000	--
Placement fees	(1,197,073)	--
<b>Net cash provided by financing activities</b>	<b>10,499,317</b>	<b>4,353,264</b>
<b>EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS</b>	<b>327,169</b>	<b>(61,764)</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>2,818,814</b>	<b>(1,080,776)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF THE PERIOD</b>	<b>1,457,900</b>	<b>1,656,546</b>
<b>CASH AND CASH EQUIVALENTS, END OF THE PERIOD</b>	<b>\$ 4,276,714</b>	<b>\$ 575,770</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for interest	\$ 473,824	\$ 19,880
	<b>2010</b>	<b>2009</b>
<b>SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING &amp; FINANCING ACTIVITIES:</b>		
Increase in Share Capital due to Acquisitions and Non-Cash Compensation	\$ 14,318,336	\$ 532,583
Increase in Share Capital due to Exercise of Warrants and Conversion of Notes	\$ 346,564	\$ -
Decrease of Net Debt due to Conversion of Notes	\$ 425	\$ -
Increase of Warrants due to fundraising of Convertible notes	7,539,585	-

The accompanying notes are an integral part of the unaudited consolidated financial statements

**ELEPHANT TALK COMMUNICATIONS, INC. AND SUBSIDIARIES**  
**NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Organization and Nature of Operations**

**The Company**

Elephant Talk Communications, Inc. (“Elephant Talk,” “we,” “us” or the “Company”), is an international provider of business software and services to the telecommunications and financial services industry. The company enables both mobile network operators (“MNOs”) and virtual operators (“MVNOs”) to offer a full suite of products, delivery platforms, support services, superior industry expertise and high quality customer service without substantial upfront investments from clients. Elephant Talk provides global telecommunication companies, MNOs, banks, supermarkets, consumer product companies, media firms, and other businesses a full suite of products and services that enables them to fully provide telecom services as part of their business offerings. The company offers various dynamic products that include remote health care, credit card fraud prevention, mobile internet ID security, multi-country discounted phone services, loyalty management services, and a whole range of other emerging customized mobile services.

*Converged telecommunication services – full MVNE solutions.* The Company is a niche player in the converged telecommunications market, providing traffic and network services as a licensed operator, and specializing in carrier grade mobile enabling platforms to provide outsourced solutions to the various players in the telecommunications’ value chain, including MNOs, MVNOs and non-operator companies in need of both mobile as well as specialized land-line telecommunication services. In this chain we position ourselves as a Full Mobile Virtual Network Enabler , including also customized mobile services such as our network integrated ValidSoft security and fraud prevention solutions.

*ValidSoft – electronic fraud prevention*

Our recent major acquisition of ValidSoft Ltd. (“ValidSoft”) gives us a position in providing solutions to counter electronic fraud relating to card, the internet, and telephone channels. ValidSoft’s solutions are used to verify the authenticity of both consumers and institutions (mutual authentication), and the integrity of transactions (transaction verification) for the mass market, in a highly cost effective and secure manner, yet easy to use and intuitive. ValidSoft solutions are marketed under VALid-POS® and VALid®. For its biometrics based product it trades under VALid-VSG™.

**Principles of Consolidation**

The accompanying consolidated financial statements for June 30, 2010 and December 31, 2009 include the accounts of Elephant Talk its wholly-owned subsidiary Elephant Talk Europe Holding B.V., its wholly-owned subsidiary Elephant Talk Communication Holding AG, its wholly-owned subsidiaries Elephant Talk Communications S.L.U., Elephant Talk Mobile Services B.V., Elephant Talk Communication Austria GmbH, Elephant Talk Telekom GmbH (formerly Vocalis Austria GmbH), Elephant Talk Communications Italy S.R.L., ET-Stream GmbH, Elephant Talk Communication Carrier Services GmbH, Elephant Talk Communication (Europe) GmbH, Elephant Talk Communication Schweiz GmbH, Moba Consulting Partners B.V., Elephant Talk Communications France S.A.S., its majority owned (51%) subsidiary Elephant Talk Communications Premium Rate Services Netherlands B.V., its majority owned (51%) subsidiary Elephant Talk Communications PRS U.K. Limited, its wholly-owned subsidiary Elephant Talk Communications Luxembourg SA, its wholly-owned subsidiary Elephant Talk Global Holding B.V., its wholly-owned subsidiary Elephant Talk Business Services W.L.L., its wholly-owned subsidiary Guangzhou Elephant Talk Information Technology Limited., its wholly-owned Elephant Talk Caribbean B.V., its majority owned (51%) subsidiary ET-UTS N.V., its wholly-owned subsidiary Elephant Talk Limited, its majority owned (60%) subsidiary Elephant Talk Middle East & Africa (Holding) W.L.L., its majority owned (51%) subsidiary Elephant Talk Middle East & Africa (Holding) Jordan L.L.C., its majority owned (99%) subsidiary Elephant Talk Middle East & Africa Bahrain W.L.L and its majority owned (50.54%) subsidiary Elephant Talk Middle East & Africa FZ-LLC and its wholly-owned subsidiary ValidSoft Limited, ValidSoft (UK) Ltd & ValidSoft (Australia) Pty Ltd.

*Acquisitions.*

On March 17, 2010, the Company acquired all of the assets of privately held ValidSoft Ltd from Ireland (“ValidSoft”) for total consideration of \$ 16,033,689 paid by the issuance of shares in the Company as well as warrants. This consideration excludes the contingent consideration payable upon ValidSoft meeting certain performance targets. The opening balance sheet of ValidSoft has been recorded as of 1 April 2010. The Consolidated Statement of Income for the three months ended June 30, 2010 include the financial results of ValidSoft as of 1 April 2010.

## **Interim Financial Information**

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and related notes as included in our 2009 Form 10-K. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements in our Form 10-K. In the opinion of management, the accompanying unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and contain all adjustments (which include only normal recurring adjustments) considered necessary for a fair presentation of our financial position, results of operations and cash flows as of and for the periods presented.

The results of operations for the six months ended June 30, 2010 are not necessarily indicative of the results to be expected for the entire year.

### **Note 2. Financial Condition and Going Concern**

The Company has an accumulated deficit of (\$89,030,994) as of June 30, 2010. Historically the Company has relied on a combination of debt and equity financings to fund ongoing cash requirements. In the first half year of 2010 the Company has received loans in the total amount of €1,850,000 (US \$2,513,195) from QAT II Investments, SA, a related party investment fund ("QAT II"). We also raised \$2,885,000 in a bridge financing of units consisting of common stock, no par value, and warrants exercisable into common stock, with accredited investors (the "Bridge Financing") Subsequent to the Bridge Financing, we conducted a private placement (the "2010 Private Placement Offering") of units consisting of shares of our common stock and warrants to accredited investors.

The first closing of the 2010 Private Placement Offering took place on June 28, 2010. In connection with the first closing, we sold units having an aggregate value of \$6,459,800 at a price of \$1.20 per unit. In connection with the first closing, we issued 5,383,175 shares of common stock and warrants to purchase up to 5,383,175 shares of common stock at \$1.50 per share. The units were offered and sold pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"). Excluding the second closing of the 2010 Private Placement Offering on August 4, 2010 (described in Note 26), we have raised gross proceeds of approximately \$11.9 million in 2010, resulting in net proceeds to us of approximately \$10.7 million.

We believe that our cash balance at June 30, 2010, in combination with the additional funding received so far in 2010, cash generated from operations and commitments for additional funding, will provide sufficient funds at least to the beginning of the next year. We continue in the short term in raising funds under our 2010 Private Placement Offering.

Although the Company has previously been able to raise capital as needed, such capital may not continue to be available at all, or if available, on reasonable terms. Further, the terms of such financing may be dilutive to existing shareholders or otherwise on terms not favorable to the Company or existing shareholders. The current global financial situation may offer additional challenges to raising the required capital. If we are unable to secure additional capital, as circumstances require, or do not succeed in meeting our sales objectives we may not be able to continue operations. As of June 2010, these conditions raised substantial doubt from our auditors as to our ability to continue as a going concern.

### **Note 3. Significant Accounting Policies**

#### **Foreign Currency Translation**

The functional currency is Euros for the Company's wholly-owned subsidiary Elephant Talk Europe Holding B.V. and its subsidiaries, and Euros for its wholly-owned subsidiary Elephant Talk Global Holding B.V., and the Hong Kong Dollar for its wholly-owned subsidiary Elephant Talk Limited and the British Pound Sterling for its wholly-owned subsidiary ValidSoft (UK) Ltd. The financial statements of the Company were translated to USD using period-end exchange rates as to assets and liabilities and average exchange rates as to revenues and expenses, and capital accounts were translated at their historical exchange rates when the capital transaction occurred. In accordance with Accounting Standard Codification ("ASC") 830, Foreign Currency Matters, (formerly known as Statement of Financial Accounting Standards ("SFAS") No. 52), net gains and losses resulting from translation of foreign currency financial statements are included in the statements of shareholder's equity as other comprehensive income (loss). Foreign currency transaction gains and losses are included in consolidated income (loss). The accumulated other comprehensive income (loss) as of June 30, 2010 and December 31, 2009 was (\$2,553,849) and \$1,136,897, respectively. The foreign currency translation gain/(loss) for the three months ended June 30, 2010 and 2009 was (\$3,168,961) and \$470,533, respectively. The foreign currency translation gain/(loss) for the six months ended June 30, 2010 and 2009 was (\$3,690,746) and (\$197,259), respectively.

### **Use of Estimates**

The preparation of the accompanying financial statements conforms with accounting principles generally accepted in the United States and requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates and assumptions.

### **Cash and Cash Equivalents**

For purposes of the cash flow statements, the Company considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents.

### **Restricted Cash**

Restricted cash represents cash deposited as bank guarantee for interconnects.

### **Accounts Receivables, net**

The Company's customer base is geographically dispersed. The Company maintains an allowance for potential credit losses on accounts receivable. Management reviews the composition of accounts receivable and analyzes historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in customer payment patterns to evaluate the adequacy of these allowances. Allowances are recorded primarily on a specific identification basis. As of June 30, 2010 and December 31, 2009 the allowance for doubtful accounts was \$595,284 and \$764,302, respectively.

### **Revenue Recognition and Deferred Revenue**

The Company's revenue recognition policies are in compliance with ASC 605, Revenue Recognition ("ASC 605"), (formerly, Staff Accounting Bulletin ("SAB 104")). Revenue is recognized only when the price is fixed or determinable, persuasive evidence of arrangement exists, the service is performed and the collectability of the resulting receivable is reasonably assured. The Company derives revenue from activities as a landline and mobile services provider with its network and its own switching technology. Revenue represents amounts earned for telecommunication services provided to customers (net of value added tax and inter-company revenue). The Company recognizes revenue from prepaid calling cards as the services are provided. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as deferred revenue. Deferred revenue represents amounts received from the customers against future sales of services since the Company recognizes revenue upon performing the services. Deferred revenue was \$0 and \$132,205 as of June 30, 2010 and December 31, 2009, respectively.

### **Cost of Service**

Cost of service includes origination, termination, network and billing charges from telecommunications operators, out payment costs to content and information providers, network costs, data center costs, facility costs of hosting network and equipment, and costs of providing resale arrangements with long distance service providers, costs of leasing transmission facilities and international gateway switches for voice and data transmission services.

### **Reporting Segments**

ASC 820, Segment Reporting, (Formerly SFAS No.131), defines operating segments as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performances. The Company allocates its resources and assesses the performance of its sales activities based upon geographic locations of its subsidiaries.



### **Stock-based Compensation**

Effective January 1, 2006, we adopted the provisions of ASC 718 “Compensation-Stock Compensation” (“ASC 718”) (formerly SFAS No. 123(R)), using the prospective approach. As a result, we recognize stock-based compensation expense for only those awards that are granted subsequent to December 31, 2005 and any previously existing awards that are subject to variable accounting, including certain stock options that were exercised with promissory notes in 2003, until the awards are exercised, forfeited, or contractually expire in accordance with the prospective method and the transition rules of ASC 718. Under ASC 718, stock-based awards granted after December 31, 2005, are recorded at fair value as of the grant date and recognized as expense over the employee’s requisite service period (the vesting period, generally three years), which we have elected to amortize on a straight-line basis.

### **Income Taxes**

The Company accounts for income taxes under ASC 740, “Accounting for Income Taxes” (“ASC 740”) (formerly SFAS No. 109). This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in the Company’s financial statements or tax returns. The measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and the tax bases of the Company’s assets and liabilities result in a deferred tax asset, ASC 740 requires an evaluation of the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or the entire deferred tax asset will not be realized. As part of the process of preparing our consolidated financial statements, we are required to estimate our income tax expense in each of the jurisdictions in which we operate. In the ordinary course of a global business, there are many transactions and calculations where the ultimate tax outcome is uncertain. Some of these uncertainties arise as a consequence of revenue sharing and reimbursement arrangements among related entities, the process of identifying items of revenue and expenses that qualify for preferential tax treatment and segregation of foreign and domestic income and expense to avoid double taxation. We also assess temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting differences. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We may record a valuation allowance to reduce our deferred tax assets to the amount of future tax benefit that is more likely than not to be realized. Although we believe that our estimates are reasonable and that we have considered future taxable income and ongoing prudent and feasible tax strategies in estimating our tax outcome and in assessing the need for the valuation allowance, there is no assurance that the final tax outcome and the valuation allowance will not be different than those that are reflected in our historical income tax provisions and accruals.

ASC 740 prescribes a recognition threshold and measurement methodology to recognize and measure an income tax position taken, or expected to be taken, in a tax return. The evaluation of a tax position is based on a two-step approach. The first step requires an entity to evaluate whether the tax position would “more likely than not” be sustained upon examination by the appropriate taxing authority. The second step requires the tax position be measured at the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement. In addition, previously recognized benefits from tax positions that no longer meet the new criteria would be derecognized.

The Company has filed, or is in the process of filing, tax returns that are subject to audit by the respective tax authorities. Although the ultimate outcome would be unknown, we believe that any adjustments that may result from tax return audits are not likely to have a material, adverse effect on our consolidated results of operations, financial position or cash flows.

### **Comprehensive Income/(Loss)**

Comprehensive income (loss) includes all changes in equity during a period from non-owner sources. Other comprehensive income refers to gains and losses that under accounting principles generally accepted in the United States are recorded as an element of shareholders’ equity but are excluded from net income. For the first six months of 2010 and 2009 the Company’s comprehensive income/(loss) consisted of its net loss and foreign currency translation adjustments.

## **Intangible Assets**

In accordance with ASC 350, "Accounting for Goodwill and other Intangible Assets" ("ASC 350") (formerly SFAS No. 142), intangible assets are carried at cost less accumulated amortization and impairment charges. Intangible assets are amortized on a straight-line basis over the expected useful lives of the assets, between three and ten years. Other intangible assets are reviewed for impairment in accordance with ASC 360, Property, Plant, and Equipment," (formerly SFAS No. 144), annually, or whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Measurement of any impairment loss for long-lived assets and identifiable intangible assets that management expects to hold and use is based on the amount of the carrying value that exceeds the fair value of the asset.

## **Property and Equipment, Internally Developed and third party Software**

Property and equipment are initially recorded at cost. Additions and improvements are capitalized, while expenditures that do not enhance the assets or extend the useful life are charged to operating expenses as incurred. Included in property and equipment are certain costs related to the development of the Company's internally developed software technology platform. The Company has adopted the provisions of ASC 985, "Software", ("ASC 985") (formerly the AICPA Statement of Position No. 98-1).

The Company has capitalized certain computer software development costs upon the establishment of technological feasibility. Technological feasibility is considered to have occurred upon completion of a detailed program design that has been confirmed by documenting the product specifications, or to the extent that a detailed program design is not pursued, upon completion of a working model that has been confirmed by testing to be consistent with the product design. Depreciation applied using the straight-line method over the estimated useful lives of the assets once the assets are placed in service. Once a new functionality or improvement is released for operational use, the asset is moved from the property and equipment category "projects under construction" to a property and equipment asset subject to depreciation in accordance with the principle described in the previous sentence.

## **Fair Value Measurements**

Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. The fair value hierarchy distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

<u>Level Input:</u>	<u>Input Definition:</u>
Level I	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level II	Inputs, other than quoted prices included in Level I, that are observable for the asset or liability through corroboration with market data at the measurement date.
Level III	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The following table summarizes fair value measurements by level at June 30, 2010 for financial assets and liabilities measured at fair value on a recurring basis:

	<u>level I</u>	<u>level II</u>	<u>level III</u>	<u>Total</u>
Warrant liabilities	\$ 28,038,455	\$ --	\$ --	\$ 28,038,455
Conversion feature	--	8,735,904	--	8,735,904
Total liabilities	<u>\$ 28,038,455</u>	<u>\$ 8,735,904</u>	<u>\$ --</u>	<u>\$ 36,774,359</u>

The carrying value of the Company's financial assets and liabilities, including cash and cash equivalents, accounts payable and accrued liabilities, are carried at historical cost basis and approximate fair value because of the short-term nature of these instruments. The carrying value of the Company's notes payable approximates fair value based on management's best estimate of the interest rates that would be available for similar debt obligations having similar terms at the balance sheet date.

### **Recently Issued Accounting Pronouncements**

In December 2007, the FASB issued guidance which is now part of ASC 810-10, "Noncontrolling Interests in Consolidated Financial Statements", an Amendment of Accounting Research Bulletin No. 51 " (formerly Statement of Financial Accounting Standards (SFAS) 160. This guidance establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, changes in a parent's ownership of a noncontrolling interest, calculation and disclosure of the consolidated net income attributable to the parent and the noncontrolling interest, changes in a parent's ownership interest while the parent retains its controlling financial interest and fair value measurement of any retained noncontrolling equity investment. The new guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. The Company adopted this guidance on January 1, 2009, the beginning of its 2009 fiscal year, which resulted in certain reclassifications related to the noncontrolling interest in the consolidated financial statements.

In April 2008, the FASB issued revised guidance on determining the useful life of intangible assets. The revised guidance, which is now part of ASC 350-30 General Intangibles Other than Goodwill (previously Staff Position No. FAS 142-3, Determination of the Useful Life of Intangible Assets), amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The guidance is effective for fiscal years beginning after December 15, 2008 and applies prospectively to intangible assets acquired after the effective date. Early adoption is not permitted. The adoption of SFAS No. ASC 350-30 did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued guidance, which is now part of ASC 825, "Interim Disclosures about Fair Value of Financial Instruments" ("ASC 825"), (formerly Financial Staff Position SFAS 107-1 and Accounting Principles Board (APB) Opinion No. 28-1). ASC 825 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. ASC 825 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 825 did not have an impact on the Company's consolidated financial statements.

In May 2009, the FASB issued new guidance for accounting for subsequent events. The new guidance, which is now part of ASC 855-10, "Subsequent Events" ("ASC 855-10") (formerly, SFAS No. 165) is consistent with existing auditing standards in defining subsequent events as events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued, but it also requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. The new guidance defines two types of subsequent events: "recognized subsequent events" and "non-recognized subsequent events." Recognized subsequent events provide additional evidence about conditions that existed at the balance sheet date and must be reflected in the company's financial statements. Non-recognized subsequent events provide evidence about conditions that arose after the balance sheet date and are not reflected in the financial statements of a company. Certain non-recognized subsequent events may require disclosure to prevent the financial statements from being misleading. The new guidance was effective on a prospective basis for interim or annual periods ending after June 15, 2009. We adopted the provisions of ASC 855-10 as required.

In June 2009, the FASB issued new guidance which is now part of ASC 105-10, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles" (ASC 105-10) (formerly Statement of Financial Accounting Standards No. 168), establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. ASC 105-10 is effective for interim and annual periods ending after September 15, 2009. The adoption of ASC 105-10 did not have a material impact on the Company's consolidated financial statements.

**Note 4. Long Term Deposit**

Long term deposits to various telecom carriers during the course of its operations and office space rental deposits amount to \$346,746 as of June 30, 2010 compared with \$330,946 as of December 31, 2009. The deposits are refundable at the termination of the business relationship with the carriers or termination of the rental contracts.

**Note 5. Prepaid Expenses and other Current Assets**

Prepaid expenses and other current assets recorded as \$2,166,298 as of June 30, 2010, compared with \$2,657,019 as of December 31, 2009.

The amounts comprise prepaid Value Added Tax ("VAT"), unvested stock related compensation for management & consultants and other general and administrative expenses.

**Note 6. Deferred Financing Costs**

Deferred financing costs consist of commissions, warrants issued to placement agents, associated expenses and legal fees for the 2009 private placement of units consisting of notes and warrants, and for the 2010 QAT convertible loans. At June 30, 2010 and December 31, 2009, deferred financing costs were \$2,117,067 and \$3,033,277, respectively, and are amortized over the terms of each of the notes and the 2010 QAT convertible loans, respectively.

**Note 7. Property & Equipment**

The Company has evaluated the nature of its systems engineering and software programming activities and relevance to its business activities and has concluded that the reclassification of these investments from Intangibles to Property and Equipment more accurately reflects the nature and financial reporting of the Company. Typically, these investments pertain to the Company's:

- Intelligent Network (IN) platform
- CRM software
- Mediation, Rating & Pricing engine
- Operations and Business Support software
- Network management tools

Property and equipment at June 30, 2010 and December 31, 2009 consist of:

	<b>Average Estimated Useful Lives</b>	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Furniture and fixtures	5	202,934	219,469
Computer, communication and network equipment	3 - 10	7,676,100	8,071,138
Software	5	3,946,873	4,410,714
Automobiles	5	115,350	135,455
Construction in progress		1,374,840	1,009,969
		<u>13,316,097</u>	<u>13,846,745</u>
Less: accumulated depreciation		<u>(6,486,893 )</u>	<u>(6,072,883 )</u>
		<u>\$ 6,829,204</u>	<u>\$ 7,773,862</u>

Total depreciation expense for the three months ended June 30, 2010 and 2009 was \$488,669 and \$509,847, respectively. Total depreciation expense for the six months ended June 30, 2010 and 2009 was \$1,149,056 and \$953,177, respectively.

**Note 8. Intangible Assets - Customer Contracts, Licenses and Interconnects**

Intangible assets include customer contracts, telecommunication licenses and integrated, multi-country, centrally managed switch-based interconnects. ValidSoft Intellectual Property, including but not limited to software source codes, applications, customer list & pipeline, registration & licenses, patents and trademark/brands.

	<u>Average Estimated Useful Lives</u>	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Customer Contracts, Licenses , Interconnect & Technology	5 - 10	\$ 10,970,482	12,282,126
Validsoft IP & Technology	1 - 10	14,404,084	--
Less: Accumulated Amortization and impairment charges		(7,882,448)	(8,371,763)
Less: Accumulated Amortization Validsoft IP & Technology		(792,751)	--
		<u>\$ 16,699,367</u>	<u>\$ 3,910,363</u>

Intangible asset amortization expense for the three months ended June 30, 2010 and 2009 was \$1,026,759 and \$197,916 respectively. Amortization expense for the six months ended June 30, 2010 and 2009 totaled \$1,211,066 and \$384,768 respectively.

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
<b>Goodwill</b>		
Goodwill at acquisition (Note 9)	\$ 3,433,833	--
End of period exchange rate translation	(387,043)	--
	<u>\$ 3,046,790</u>	<u>\$ 0</u>

Estimated future amortization expense related to our intangible assets is:

	<u>2010 remainder</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2015 thereafter</u>
Interconnect licenses and contracts	344.421	688.843	686.974	666.429	588.674	112.694	-
ValidSoft IP & Technology	1,529.921	2,734.360	2,734.360	2,734.360	2,734.360	756.823	387.148
	<u>1,874.342</u>	<u>3,423.203</u>	<u>3,421.334</u>	<u>3,400.789</u>	<u>3,323.034</u>	<u>869.517</u>	<u>387.148</u>

**Note 9 Acquisition of ValidSoft Ltd**

On March 17, 2010 we issued 10,235,739 shares and 3,829,487 warrants as purchase price consideration following the completion of the acquisition of ValidSoft of which 2,558,937 shares and 957,373 warrants are contingent upon meeting specific targets following a stepped earn-out agreement. Based upon a number major contracts not being concluded yet at reporting date, the Company does not assume that the targets as set for the contingent consideration to be released, will be met at this point in time. Consequently, the total value for the consideration is \$16,033,688 comprising the fair market value for the non-contingent shares of \$12,129,352 and non-contingent warrants of \$3,904,336. The contingent consideration is held in escrow. The Company will continue to monitor the progress made and determine quarterly to which extent parts of the stepped targets are likely to be met.

<u>Consideration paid</u>	<u>Total Consideration</u>	<u>Non-Contingent Consideration</u>	<u>Contingent Consideration</u>
Number of shares	10,235,739	7,676,805	2,558,934
Fair value (share price at 17 March 2010)	\$ 1,58	\$ 12,129,352	-
Numer of warrants	3,829,487	2,872,114	957,373
Fair Value (black-scholes)		\$ 3,904,336	
<b>Total Consideration Paid</b>		<u>\$ 16,033,688</u>	

Following the valuation of ValidSoft, we allocated the above purchase price to the identifiable assets and liabilities of ValidSoft.

A summary of the assets acquired and liabilities assumed for ValidSoft are:

Estimated fair values:	
Assets acquired	\$ 16,677,323
Liabilities assumed	4,077,467
Net assets acquired	12,599,856
Consideration paid	16,033,688
Goodwill	\$ 3,433,833

The operating results of ValidSoft have been consolidated with those of the Company starting April 1, 2010.

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION DISCLOSURE FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009

The following un-audited pro forma consolidated financial information for the six months ended June 30, 2010 and 2009, as presented below, reflects the results of operations of the Company as of April 1, 2010 and assuming that the acquisition occurred on April 1, 2009, respectively, and after giving effect to the purchase accounting adjustments. These pro forma results have been prepared for information purposes only and do not purport to be indicative of what operating results would have been had the acquisitions actually taken place on April 1, 2010 and 2009 respectively, and may not be indicative of future operating results.

Pro forma consolidated	June 30, 2010	June 30, 2009
Revenues	\$ 19,674,169	\$ 20,804,620
Operating loss	(8,792,293)	(7,139,525)
Net loss	(27,180,023)	(7,252,052)
Loss per share - basic and fully diluted	(0.44)	(0.12)

Note: For comparison purposes with 2009 Operating Loss of (\$8,792,293) and Net loss of (\$27,180,023) are exclusive of the amortization charge incurred of \$792,751 in the three months ending March 31, 2010 following the Fair Market Valuation of the assets of ValidSoft.

The Company included the financial results of ValidSoft in its consolidated 2010 financial results from the date April 1, 2010 through June 30, 2010.

Further details on the acquisition of ValidSoft can be found in our Current Report on Form 8-K/A filed June 2, 2010.

**Note 10. Overdraft**

In 2004, Elephant Talk Ltd. executed a credit facility with a bank in Hong Kong pursuant to which Elephant Talk Ltd. has borrowed funds from the bank. As of June 30, 2010 the overdraft balance included accrued interest amounted to \$263,294 compared to \$250,023 as of December 31, 2009. The interest rate and default payment interest rate were charged at 2% and 6% per annum above the Lender's Hong Kong Dollar Prime Rate quoted by the Lender from time to time. The Company has not guaranteed the credit facility nor is it otherwise obligated to pay funds drawn upon it on behalf of Elephant Talk Ltd. As of June 30, 2010 Moba Consulting Partners B.V. had an overdraft of \$90,610 compared to \$101,566 as of December 31, 2009 on one of the company's bank accounts.

**Note 11. Accrued Expenses**

As of June 30, 2010 and December 31, 2009, the accrued expenses comprised of the following:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Accrued Selling, General & Administrative expenses	\$ 1,975,507	\$ 589,630
Placement fees	—	—
Accrued cost of sales and network	297,885	307,172
Accrued taxes	1,528,727	855,370
Accrued interest payable	1,260,645	552,393
Other	489,649	434,432
<b>Total accrued expenses</b>	<b>\$ 5,552,413</b>	<b>\$ 2,738,998</b>

**Note 12. Convertible 14% loan – related party**

The Company received interest-bearing loans in the first quarter at 14% per annum from QAT II . The loans are due to be repaid 180 days after the date the loans were made available to the Company or in the event another person or entity consummates an equity or debt securities financing with the Company in the amount of at least \$5,000,000, upon notice to the Company.

These loans included the option of conversion into equity under certain conditions. An amendment to the Loan Agreement dated June 10, 2010, has affected the term and conditions of the agreement. See Note 25: Related Party Transactions, for more information.

The principal convertible 14% loan amount to €1,850,000 and is subject to re-valuation on monthly basis, the current outstanding amount is \$2,258,480 as of June 30, 2010.

**Breakdown of Convertible 14% Note**

	<b>Principal</b>	<b>Discount</b>	<b>Net Liability</b>
Convertible 14% note - related party	\$ 2,258,480	\$ (1,421,941)	\$ 836,539
<b>Totals</b>	<b>\$ 2,258,480</b>	<b>\$ (1,421,941)</b>	<b>\$ 836,539</b>

**Note 13. Loans Payable**

Loans payable at June 30, 2010 and December 31, 2009 are summarized as follows:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Installment loan payable due December 24, 2006, secured by personal guarantees of two shareholders, a former director, and a third party	\$ 319,121	\$ 320,339
Installment loan payable, bank, monthly principal and interest payments of \$2,798 including interest at bank's prime rate plus 1.5% per annum, 8.25% at November 30, 2008, due December 24, 2011, secured by personal guarantees of three shareholders and a former director	190,679	191,407
Installment loan payable, bank, monthly principal and interest payments of \$1,729 including interest at bank's prime rate plus 1.5% per annum, 8.25% at November 24, 2008, due June 28, 2009, secured by personal guarantees of three shareholders and a former director	84,782	85,106
Term loan payable, bank, monthly payments of interest at bank's prime rate, 7.0% at June 30, 2010	282,605	283,684
<b>Total</b>	<b>\$ 877,187</b>	<b>\$ 880,536</b>

Elephant Talk Ltd. executed a credit facility with a bank in Hong Kong on June 29, 2004 under which Elephant Talk Ltd. has borrowed funds from the bank under three installment loans and a term loan arrangement. Elephant Talk Ltd. is in default of making loan payments on all the loans and has recorded an accrued interest amounting to \$594,652 as of June 30, 2010. As a result of the default, the entire loan balance outstanding at June 30, 2010 is due and payable to the bank. Furthermore, Elephant Talk Ltd. is obligated to pay a default interest rate at the rate of 4.25% per annum in addition to the prescribed interest rate of the installment loans and term loan. Elephant Talk Ltd. has recorded \$4,787 and \$12,767 in interest expense and default interest expense, respectively, on loans payable as of June 30, 2010 and June 30, 2009 and \$37,655 and \$53,681 in interest expense as of June 30, 2010 and June 30, 2009, respectively. The Company has not guaranteed the credit facility nor is it otherwise obligated to pay funds drawn upon it on behalf of Elephant Talk Ltd.

**Note 14. Long term debt**

The Company's 51% owned subsidiary ET-UTS N.V. has received \$450,436 in interest bearing (8% per annum) unsecured loans from United Telecommunication Services N.V., the 49% shareholder in the subsidiary. No maturity has been fixed.

**Note 15. 12% Secured Convertible Promissory Notes**

On July 31, August 18, September 3, September 30 and October 30, 2009, the Company consummated closings of its 2009 private placement offerings of units (the "2009 private placement") comprised of 12% secured convertible promissory notes (the "Notes") and warrants (the "Warrants") to purchase shares of common stock to accredited. The securities were offered and sold pursuant to an exemption from registration under Section 4(2) of the Securities Act. The Company sold an aggregate of \$12,333,020 principal amount of Notes and delivered Warrants to purchase an aggregate of 12,333,020 shares of the Company's common stock at a purchase price of \$1.00 per share. The Company used the net proceeds from the 2009 private placement primarily for working capital.

The value of the Warrants to the investors of the 2009 private placement has been capitalized and off set against the liability for the Notes. This resulted in a debt discount of \$12,333,020 incurred in connection with the private placement. The debt discount will be amortized over the term of the Notes using the effective interest method.

<b>Breakdown of Convertible 12% Secured Note</b>	<b>Principal</b>	<b>Conversions</b>	<b>Net Principal</b>	<b>Net Discount</b>	<b>Net Liability</b>
Convertible 12% secured note - related party	\$ 5,332,383	\$ 0	\$ 5,332,383	\$ 5,290,625	\$ 41,758
Convertible 12% secured note - third party	\$ 7,000,637	\$ 111,000	\$ 6,889,637	\$ 6,835,716	\$ 53,922
<b>Totals</b>	<b>\$ 12,333,020</b>	<b>\$ 111,000</b>	<b>\$ 12,222,020</b>	<b>\$ 12,126,341</b>	<b>\$ 95,680</b>

The Notes are convertible at the option of the holder into no par value common stock of the Company at a conversion price equal to \$1.35. During the second quarter of 2010 a principal amount of \$111,000 of the outstanding Notes were converted into common stock. This has resulted in an accelerated accretion of the relating debt discount (see "Breakdown of Convertible 12% Secured Note Disclunt," below). The related number of common stock issued is 83,292 which also included such noteholder's accumulated interest up to their resepective dates of conversion.

<b>Breakdown of Convertible 12% Secured Note Discount</b>	<b>Initial Discount</b>	<b>Regular Accretions</b>	<b>Accelerated Accretions</b>	<b>Net Discount</b>
Convertible 12% secured note - related party	\$ 5,332,383	\$ 41,758	\$ -	\$ 5,290,625
Convertible 12% secured note - third party	\$ 7,000,637	\$ 54,346	\$ 110,575	\$ 6,835,716
<b>Totals</b>	<b>\$ 12,333,020</b>	<b>\$ 96,104</b>	<b>\$ 110,575</b>	<b>\$ 12,126,341</b>

The conditions of the outstanding \$5.3 million Note to QAT II was amended on June 10, 2010, has accepted a forced conversion of their outstanding \$5.3 million Note when an aggregate amount of \$11 million is raised in connection with the 2010 Private Placement Offering. See Item 2, "Unregistered Sales of Equity Securities and Use of Proceeds," for further information. The valuation in Note 17 of the "Conversion Feature" is based upon our expectation that we will raise at least \$11 million in connection with the 2010 Private Placement Offering.



## Note 16. Warrant liabilities

	Initial Fair Value	Fair Mark-to-Market Value as per December 31, 2009	Fair Mark-to-Market Value as per June 30, 2010
<b>Outstanding warrants consisted of the following as of June 30, 2010:</b>			
Investor Warrants - Related to 2009 Prom Note issue	\$ 14,284,242	\$ 14,359,363	\$ 17,042,503
Placement Agent Warrants - Related to the 2009 Prom Note issue	\$ 2,285,479	\$ 2,266,762	\$ 2,418,250
2010 QAT II Loan Warrants (part I)	\$ 3,042,617	\$ -	\$ 2,859,234
2010 QAT II Loan Warrants (part II)	\$ 5,718,467	\$ -	\$ 5,718,467
	<u>\$ 25,330,805</u>	<u>\$ 16,626,125</u>	<u>\$ 28,038,455</u>

### Investor and placement agent warrants – 12% secured convertible note

We issued the Warrants in connection with the 2009 private placement. The Warrants include conversion provisions that require us to record them at fair value as a liability in accordance with ASC 815 (formerly EITF 00-19), with subsequent changes in fair value recorded as a non-operating gain or loss in our statement of operations. The fair value of the warrants is determined using a Black-Scholes option pricing model, and is affected by changes in inputs to that model including our stock price, expected stock price volatility, interest rates and expected term. The fair value of the Warrants issued to investors and placement agents in connection with the 2009 private placement was \$16,569,721 upon issuance and is valued at \$19,460,753 as of June 30, 2010.

During the second quarter of 2010 some of the Warrants relating to the 2009 private placement were exercised. The total outstanding number of Warrants, including the warrants issued to the selling agents has decreased by 669,828. The total outstanding Warrants, including the warrants issued to the selling agent in connection with the 2009 private placement has become 13,636,475 Warrants. The number of shares is not increased by the same number as the exercised warrants as the warrant agreement includes a cashless exercise option.

	Initial number of warrants issued	Exercised	Outstanding warrants
<b>Outstanding warrants consisted of the following as of June 30, 2010:</b>			
Investor Warrants - Related to 2009 Prom Note issue	12,333,020	390,000	11,943,020
Placement Agent Warrants - Related to the 2009 Prom Note issue	1,973,283	279,828	1,693,455
	<u>14,306,303</u>	<u>669,828</u>	<u>13,636,475</u>

### 2010 QAT II loan warrants

In the first quarter of 2010, 2,513,195 warrants were issued to QAT II as part of the loan agreements for the loans granted for a total amount of €1,850,000. The total value of these warrants has initially been valued at \$3,042,617 and as per June 30, 2010 they are valued at \$2,859,234. The change in fair value of \$183,383 was recorded in the income statement.

During the second quarter, we amended the convertible 14% loan agreements with QAT II, resulting in the issuance of an additional 5,026,390 warrants to QAT II. These warrants were valued at \$5,718,467 and recorded as a warrant liability on the balance sheet and as an expense in the income statement.

For details on the abovementioned amendment see Note 25: “Related Party Transactions”.

### ValidSoft acquisition warrants

In the first quarter of 2010, we acquired ValidSoft Ltd. The former shareholders were granted warrants on our common shares as part of the acquisition price. The initial value of these warrants was \$3,904,337 and has been accounted for as capital in the common stock section of the balance sheet.

## Note 17. Conversion feature

### 12% secured convertible note

A conversion feature (holders of the Notes will receive a discount of 15% when converting the Note into shares instead of cash repayment) was recognized at fair value on the respective issuance dates of the Notes as a discount and will be amortized using the effective interest rate method from issuance to the maturity date of the respective Notes. The conversion feature has been marked to market each previous reporting dates with subsequent changes in fair value which have been recorded as non-operating gains or losses in our income statement.

Pursuant to the terms of the Notes, we determined the conversion price to be \$1.35. This amount is equal to eighty-five percent (85%) of the twenty (20) day average closing price of our common stock for the twenty (20) trading days prior to March 31, 2010. Note holders may convert their Notes into shares of common stock at the conversion price, in full or in part, at any time before the maturity date. Since this conversion feature has the characteristics of an option to purchase shares at a fixed price per share, the fair market value was calculated by using the Black-Scholes option pricing model. The fair value of the existing conversion feature was \$7,479,151 as of June 30, 2010.

The 2010 valuation of the conversion feature described above is based upon our expectation that the current equity raise of the Private Placement Offering will be at least \$11 million which will cause the automatic conversion of the Note held by QAT II in accordance with the conversion terms equal to the 2010 Private Placement Offering of \$ 1.20 per share.

#### *2010 QAT II loans*

During the first quarter of 2010, the company received additional loans from QAT II aggregating a total of €1,850,000 (with a current book value of \$2,258,480) which included the right for QAT II to convert the principal and accrued interest outstanding as of the date of the consummation of an equity or debt financing in the amount of at least US\$5,000,000 (a "Placement") into the same type of equity or debt securities issued in connection with the Placement and pursuant to the same terms and conditions of such Placement. The conversion share price has been determined at \$1.20 and the conversion date for valuation purposes has been set at August 31, 2010. Since this conversion feature has the characteristics of an option to purchase shares at a fixed price per share, the fair market value was calculated by using the Black-Scholes option pricing model. The fair value of the existing conversion feature has been calculated at \$1,256,753 as of June 30, 2010.

<b>Outstanding Conversion Feature Liability consisted of the following as of June 30, 2010:</b>	Initial Fair Value	Fair Mark-to-Market Value as per December 31, 2009	Fair Mark-to-Market Value as per June 30, 2010
Conversion Feature - Related to 15% discount on 2009 Prom Note issue	\$ 2,418,819	\$ 2,899,801	\$ 7,479,151
Conversion Feature - Related to conversion right 2010 QAT II Loans	\$ 250,000	\$ 0	\$ 1,256,753
	<u>\$ 2,668,819</u>	<u>\$ 2,899,801</u>	<u>\$ 8,735,904</u>

#### **Note 18. Stockholders' Equity**

##### **(A) Common Stock**

The Company is presently authorized to issue 250,000,000 shares common stock. The Company had 65,812,367 shares of common shares issued and outstanding as of June 30, 2010, an increase of 12,116,383 shares since December 31, 2009, largely due to the shares issued in connection with the ValidSoft acquisition, the Bridge Financing, and shares issued as compensation. The number excludes the 245,900 unreturned and the 2,558,934 escrowed contingent shares mentioned below. The number shares issued and outstanding as of August 13, 2010 is 75,699,642, which includes 245,900 shares which were cancelled by the Company prior to 2006 as well as the 2,558,934 contingent shares issued for the ValidSoft acquisition. The 245,900 shares were not returned to our transfer agent and never cancelled on their records. These shares have been blocked for trading by our transfer agent. The contingent shares are held in escrow for the contingent consideration of the ValidSoft consideration. The contingent consideration will be recorded when the contingency is resolved.

##### *ValidSoft acquisition warrants*

In the first quarter of 2010, we acquired ValidSoft. The former shareholders were granted warrants on our common shares as part of the acquisition price. The initial value of these warrants was \$3,904,337 and has been accounted for as capital in the common stock.

##### **(B) Shares to be issued**

Following the sale of securities under the Bridge Financing, the 2010 Private Placement, exercise of warrants and shares issued as compensation, a total number of 5,881,733 shares remain to be issued, valued at \$ 7,161,795.

**Note 19. Basic and Diluted Net Loss Per Share**

Net loss per share is calculated in accordance with ASC 260 "Earnings per Share" (formerly SFAS No.128). Basic net loss per share is based upon the weighted average number of common shares outstanding. Dilution is computed by applying the treasury stock method. Under this method, options and warrants are assumed to be exercised at the beginning of the period (or at the time of issuance, if later), and as if funds obtained thereby were used to purchase common stock at the average market price during the period. Weighted average number of shares used to compute basic and diluted loss per share is the same since the effect of dilutive securities is anti-dilutive.

**Note 20. Employee Benefit Plan and Non-Qualified Stock Option and Compensation Plan****2000 Employee Benefit Plan**

The Company adopted an employee benefit plan "The 2000 Employee Benefit Plan" (the "Plan") on May 30, 2000. Under the Plan, the Company may issue shares or grant options to acquire the Company's common stock, no par value, from time to time to employees of the Company or its subsidiaries. In addition, at the discretion of the Board of Directors, shares may be granted under this Plan to other individuals, including consultants or advisors, who contribute to the success of the Company or its subsidiaries, provided that bona fide services shall be rendered by consultants and advisors and such services must not be in conjunction with the offer or sale of securities in a capital raising transaction. No stock may be issued or options granted under the Plan to consultants, advisors or other persons who directly or indirectly promote or maintain a market for the Company's securities. The Plan is intended to aid the Company in maintaining and developing a management team, attracting qualified officers and employees capable of assuring the future success of the Company, and rewarding those individuals who have contributed to the success of the Company. The Plan is administrated under the direction of the Board of Directors. A total of 160,000 common shares and 160,000 stock options to acquire common shares may be subject to, or issued pursuant to, benefits granted under the Plan. At any time any stock option is granted under the terms of this Plan, the Company will reserve for issuance the number of shares of stock subject to such option until it is exercised or expired. The Plan Administrator shall determine from time to time the terms, conditions and price of the options granted. Options shall not be construed to be stock and cannot be exercised after the expiration of its term. Under the Plan, 12,000 shares of common stock and 160,000 stock options remain available for grant at June 30, 2010.

**2006 Non-Qualified Stock and Option Compensation Plan**

Under our 2006 plan there are, as of June 30, 2010, 344,342 stock options outstanding. There are remaining 600,000 shares and 55,658 stock options available for grant.

Options granted generally vest over a three year period. Options generally expire two years from the date of vesting.

Common stock purchase options and warrants consisted of the following as of June 30, 2010:

	<u>Number of shares</u>	<u>Exercise Price</u>	<u>Initial Fair Market Value</u>
<b>Options:</b>			
Outstanding as of December 31, 2009	344,342	\$ 2.25	\$ 453,917
Granted in 2010	—	—	—
Exercised	—	—	—
Cancelled/Forfeited	—	—	—
Outstanding as of June 30, 2010	<u>344,342</u>	<u>\$ 2.25</u>	<u>\$ 453,917</u>

The options were granted with an exercise price of \$2.25, the share closing price as of September 26, 2007. The options generally vested as of December 31, 2009, or will vest (if unvested) if there is a change of control in the Company.

No options have been issued or granted under this plan in 2010.

Following is a summary of the status of options outstanding under the 2006 plan at June 30, 2010:

Range of Exercise Prices	Options outstanding			Options exercisable	
	Total Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
\$ 2.25	344,342	1.86	\$ 2.25	269,342	\$ 2.25

At June 30, 2010, the total compensation cost related to unvested stock-based awards granted to employees under the provisions of ASC 718 and the Company's 2006 stock award plan, but not yet recognized was approximately \$24,991.

#### 2008 Long-Term Incentive Plan

The 2008 Long-Term incentive plan was adopted on January 15, 2008, and approved by our shareholders on the same date at our annual meeting. The 2008 Long-Term incentive authorizes awards of up to 5,000,000 shares of common stock, in the form of incentive and non-qualified stock options, stock appreciation rights, performance units, restricted stock awards and performance bonuses. The amount of common stock underlying the awards to be granted remained the same after the 25 to one reverse stock-split that was effectuated on June 11, 2008. As of June 30, 2010, a total of 3,742,000 stock options and 507,300 shares had been granted under this plan. Options granted generally begin vesting over a three-year period after grant date although options have been granted with a shorter period than three years. Options granted in the beginning expire two years from the date of vesting but the latest in 2010 issued options remain exercisable for nine years from the date of vesting. It is expected that future options will be awarded with the nine-year exercise period after first vesting.

Common stock purchase options and warrants consisted of the following as of June 30, 2010:

	Number of shares	Average Exercise Price	Initial Fair Market Value
<b>Options:</b>			
Outstanding as of December 31, 2009	976,000	\$ 0.89	\$ 758,900
Granted in 2010	2,934,000	\$ 1.42	\$ 3,999,228
Exercised	—	—	—
Cancelled/Forfeited	40,500	\$ 1.21	\$ 46,642
Outstanding as of June 30, 2010	3,869,500	\$ 1.29	\$ 4,711,486

The options granted pursuant to this plan in 2010 were granted with an average exercise price of \$1.42. The initial fair market value of the options granted using the Black-Scholes options model for these options has been valued at \$3,999,228 at their initial grant-dates. In the second quarter we have reconsidered the churn rate we use in our model for employees leaving the company before the date of exercise. The churn rate was changed from 16.19% to 1.58% because few employees left the Company during the previous two years. The results, \$112,128 (2009) and \$554,446 (2010), have been included in our income statement for the period ending June 30, 2010.

Following is a summary of the status of options outstanding under the 2008 Long-Term Incentive Plan at June 30, 2010:

Range of Exercise Price	Options outstanding			Options exercisable	
	Total Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
\$ 0.60-1.98	3,869,500	8.26 years	\$ 1.287	283,334	\$ 1.09

The weighted average assumptions used so far for the options granted in 2010 using the Black-Scholes options model are: volatility of 142%, term of 9.95 years and a Risk Free Interest Rate assumption of 3.768%. The expected dividend yield is zero.

At June 30, 2010 the total compensation cost related to unvested stock-based awards granted to employees under the provisions of ASC 718 and the Company's 2008 stock award plan, but not yet recognized in the profit and loss was approximately \$3,161,472

**Note 21. Commitments**

As of June 30, 2010 commitments of the Company relating to leases, co-location, interconnect and office rents are as follows:

December 31, 2010	\$ 1,466,802
December 31, 2011	2,884,307
December 31, 2012	2,336,598
December 31, 2013	2,001,149
December 31, 2014	428,492
<b>Total</b>	<b>\$ 9,117,348</b>

**Note 22. Minority interests in subsidiaries**

The Company had minority interests in several of its subsidiaries. The balance of the minority interests as of June 30, 2010 and December 31, 2009 were as follows:

Subsidiary	Noncontrolling Interest %	Noncontrolling interest Balance at	
		June 30, 2010	December 31, 2009
ETC PRS UK	49%	\$ 8,955	\$ 10,516
ETC PRS Netherlands	49%	119,614	140,462
ET ME&A Holding WLL	40%	—	—
ET Bahrain WLL	1%	5,461	3,180
ET ME&A FZ LLC	49.46%	35,244	35,242
ET UTS Curacao	49%	—	—
<b>Total</b>		<b>\$ 169,274</b>	<b>\$ 189,400</b>

**Note 23. Litigation**

**(a) Rescission of the Purchase Agreement of May 24, 2004 of New Times Navigation Limited.**

As previously described in our 2004 Annual Report we and New Times Navigation Limited mutually agreed to terminate this purchase agreement. We returned the received shares of New Times Navigation Limited to the concerned shareholders and received back 90,100 of our common stock out of the 204,000 issued by us for the purchase. In addition we issued 37 unsecured convertible promissory notes for a total amount of \$3,600,000. On our request 21 notes were returned with a total value of \$2,040,000.

We are presently seeking relief from the High Court of the Hong Kong Special Administrative Region against the holders of the unreturned shares to return a total of 113,900 common shares (valued at \$381,565) and also to have them return the remaining 18 unsecured convertible promissory notes representing a total amount of \$1,740,000 and rescind the purchase agreement. The case is currently pending.

**(b) Manu Ohri Litigation**

On March 26, 2009, an action was commenced against the Company by Manu Ohri ("Ohri"), our former Chief Financial Officer, in the California Superior Court, Orange County, in a matter entitled Manu Ohri v. Elephant Talk Communications, Inc., Case No. 30-20009-00120609. Ohri alleges breach of a written contract, breach of an oral contract, and a common count for services rendered. Ohri claims, among other things, \$427,816 in unpaid severance payments, \$56,951 owed under an oral consulting agreement, and stock options payable under the oral consulting agreement with a net value of \$622,000. The Company denies all material allegations of Ohri's complaint and asserts various affirmative defenses. The Company also filed and served a cross-complaint against Ohri, who then filed and served an answer, denying the material allegations of the Company's cross-complaint.

The parties are engaged in pretrial discovery, and a jury trial is scheduled to start December 6, 2010.

**(c) Bruce Barren Litigation**

On December 30, 2009, an action was commenced against the Company by Bruce Barren (“Barren”), a former director of the Company from January 2008 to May 2009, in the California Superior Court, Los Angeles County, in a matter entitled Bruce Barren v. Elephant Talk Communications, Inc., Case No. BC429032. Barren alleges causes of action for breach of a restricted stock agreement, breach of the implied covenant of good faith and fair dealing, breach of an oral employment agreement, and common counts for services rendered—despite entering into a settlement agreement and full release of any claims against the Company shortly after his resignation in May 2009. The Company contends that Mr. Barren’s claims are without merit, and has answered his complaint, denying all material allegations and asserting various affirmative defenses.

The parties are engaged in pretrial discovery, and a jury trial is scheduled to start February 7, 2011.

**(d) Chong Hing Bank Litigation**

On December 15, 2009, an action was commenced against the Company by Chong Hing Bank Limited, fka Liu Chong Hing Bank Limited, a publicly listed Hong Kong company (the “Bank”), in the California Superior Court, Orange County, in a matter entitled Chong Hing Bank Limited v. Elephant Talk Communications, Inc., Case No. 30-2009-00328467. The Bank alleges that it entered into various installment loan agreements and an overdraft account with Elephant Talk Limited (“ETL”), a Hong Kong subsidiary of the Company. The Bank alleges that ETL is in default on the loans and overdraft account, and that \$1,536,792.28 plus interest is currently due. The Bank alleges that the Company is liable to repay the loans and overdraft account. The Bank is suing the Company for breach of contract and common counts. The Company has answered the complaint, denying all material allegations and asserting various affirmative defenses.

The parties are engaged in pretrial discovery, and a jury trial is scheduled to start February 14, 2011.

**Note 24. Segment Information****Year ended June 30, 2010**

	EUROPE				Total	Far East Hong Kong / China	Middle East	The Americas	TOTAL
	Netherlands	Spain	Switzerland	Others					
Revenues from unaffiliated customers:	\$ 14,686,376	845,412	3,390,316	171,730	\$ 19,093,835	\$ -	\$ 498,243	\$ 25,512	\$ 19,617,590
Operating income (loss)	\$ (1,144,634)	\$ (150,455)	\$ (1,378,778)	\$ (1,617,320)	\$ (4,291,188)	\$ (110,673)	\$ 83,000	\$ (4,041,332)	\$ (8,360,192)
Net income (loss):	\$ (1,128,465)	\$ (150,455)	\$ (1,374,717)	\$ (1,634,220)	\$ (4,287,858)	\$ (568,246)	\$ 83,000	\$ (21,923,616)	\$ (26,696,719)
Identifiable assets	\$ 7,548,577	\$ 1,136,100	\$ 9,391,821	\$ 17,779,896	\$ 35,856,394	\$ 550,564	524,086	4,456,005	\$ 41,387,048
Depreciation and amortization	\$ (57,131)	\$ (106,945)	\$ (1,011,735)	\$ (857,114)	\$ (2,032,925)	\$ (27,709)	\$ (16,481)	\$ (283,007)	\$ (2,360,122)
Capital expenditure	\$ 1,446	\$ 1,989	\$ 1,215,023	\$ -	\$ 1,218,458	\$ (20,781)	\$ -	\$ 16,609	\$ 1,214,286

**Year ended June 30, 2009**

	EUROPE				Total	Far East Hong Kong / China	Middle East	The Americas	TOTAL
	Netherlands	Spain	Switzerland	Others					
Revenues from unaffiliated customers:	\$ 15,812,063	\$ 1,105,997	\$ 2,896,008	\$ 322,238	\$ 20,136,307	\$ 690	\$ 603,286	\$ -	\$ 20,740,282
Operating income (loss)	\$ (811,298)	\$ 157,194	\$ (1,375,495)	\$ (186,754)	\$ (2,216,354)	\$ (141,575)	\$ (35,796)	\$ (2,250,749)	\$ (4,644,473)
Net income (loss):	\$ (801,211)	\$ 157,194	\$ (1,375,383)	\$ (186,496)	\$ (2,205,896)	\$ (611,163)	\$ (37,205)	\$ (1,977,398)	\$ (4,831,661)
Identifiable assets	\$ 5,479,037	\$ 1,603,571	\$ 11,091,128	\$ 558,253	\$ 18,731,989	\$ 276,129	\$ 615,910	\$ 1,671,658	\$ 21,295,686
Depreciation and amortization	\$ (50,043)	\$ (97,800)	\$ (825,239)	\$ (2,044)	\$ (975,126)	\$ (23,857)	\$ (20,752)	\$ (318,209)	\$ (1,337,945)
Capital expenditure	\$ 24,628	\$ 1,260	\$ 1,873,724	\$ -	\$ 1,899,612	\$ 181,079	\$ -	\$ 187,907	\$ 2,268,598

**Note 25. Related Party Transactions***12% Secured convertible note*

On June 10, 2010 and at our request, QAT II entered into an agreement with us calling for the mandatory conversion of the total principal amounts outstanding under the Notes to QAT II (\$4 million issued July 31, 2009 and \$1.3 million issued October 31, 2009, totaling \$ 5.3 million), in case the Company raises a minimum of \$ 11 million in connection with the 2010 Private Placement Offering.

The Company and QAT II agreed the unpaid principal due pursuant to the Notes, excluding any accrued but unpaid interest or other fees due on such Notes, would be exchanged for units, at a price of \$1.20 per unit and on the same terms and conditions as the 2010 Private Placement Offering, upon our raising an aggregate of \$11 million in connection with our 2010 Private Placement Offering (also see item "Unregistered Sales of Equity Securities and Use of Proceeds").

*Loan agreements*

On February 2, 2010, we entered into a loan agreement with QAT II. Pursuant to this loan agreement, QAT II Investments agreed to lend to us the sum of €350,000 (\$488,775 based on the February 2, 2010 exchange rate published in the Wall Street Journal). The proceeds were made available to the Company on February 2, 2010.

On February 24, 2010, we entered into a loan agreement with QAT II. Pursuant to this loan agreement, QAT II Investments agreed to lend us the sum of €850,000 (\$1,150,390 based on the February 24, 2010 exchange rate published in the Wall Street Journal). The proceeds of the loan agreement were made available to the Company on February 24, 2010.

On March 22, 2010, we entered into a loan agreement with QAT II. Pursuant to this loan agreement, QAT II Investments agreed to lend us the sum of €150,000 (\$203,280 based on the March 22, 2010 exchange rate published in the Wall Street Journal). The proceeds of the loan agreement were made available to the Company on March 22, 2010.

On March 30, 2010, we entered into a loan agreement with QAT II. Pursuant to the loan agreement, QAT II Investments agreed to lend us the sum of €500,000 (\$670,750 based on March 30, 2010 exchange rate published in the Wall Street Journal). The proceeds of the loan agreement were made available to the Company on March 31, 2010.

Each of the above mentioned loan agreement initially provided that we would pay QAT II interest at a rate of fourteen percent (14%) per annum on the outstanding balance and provided the principal and interest shall be due and payable on the earlier of: (i) within 180 days from the date of the loan or (ii) in the event we consummate a Placement. QAT II has the ability to convert the principal and accrued interest outstanding as of the date of the Placement into the same type of equity or debt securities issued by us and on the same terms and conditions offered to other investors in the Placement. The outstanding principal and interest becomes immediately due and payable in the event we fail to make required payments of principal and interest, or otherwise breach the loan agreement and fail to cure such breach upon twenty days notice, or if we dispose of our properties or assets without QAT II's prior consent, or if we file a petition for bankruptcy or otherwise resolves to wind up our affairs.

In connection with the above-referenced loans, we also issued to QAT II warrants to purchase common stock in an amount equal to one warrant per each United States dollar loaned hereunder to the Company (using the Euro-United States dollar conversion rate published by the Wall Street Journal at the close of business of the loan date). Such warrants have a term of three years and an exercise price equal to the OTCBB closing price of our common stock on the loan date.

The loan agreements described above were amended on June 10, 2010. Pursuant to the amendment, QAT II agreed to extend the existing maturity dates of the loans to May 1, 2011. The amendment also provides for the automatic conversion of the Notes if we raise at least \$11 million in connection with the 2010 Private Placement Offering. The unpaid principal of such loans will convert into units consisting of common stock and warrants at a price of \$1.20 per unit. Further, the units will be issued on the same terms and conditions as the units being offering in the 2010 Private Placement Offering. Accrued but unpaid interest and any other fees due on the QAT II loans will not convert into units. As additional consideration for entering into the amendment, QAT II was issued warrants to purchase common stock at an amount equal to two (2x) the existing warrant coverage under the terms of such loan agreement.

#### **Note 26. Subsequent Events**

On August 4, 2010, we consummated the second closing 2010 Private Placement Offering to accredited investors. The units, consisting of common stock and warrants, were offered and sold pursuant to an exemption from registration under Section 4(2) of the Securities Act. We sold units having an aggregate value of \$1,482,700 at a price of \$1.20 per unit. In connection with this second closing, we issued 1,235,857 shares of common stock and warrants to purchase up to 1,235,587 shares of common stock at \$1.50 per share. We intend to use the net proceeds primarily for working capital.

The warrants entitle the holders to purchase shares of common stock for a period of five years from the date of issuance and contain standard anti-dilution rights. In the event: (i) the trading price of our common stock exceeds \$2.25 for twenty consecutive trading days and (ii) there is an effective registration statement with a current prospectus on file with the Securities and Exchange Commission, the Company has the option to redeem the warrants issued in the 2010 Private Placement Offering.

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

##### Forward-Looking Statements

*Any forward looking statements made herein are based on current expectations of the Company, involve a number of risks and uncertainties and should not be considered as guarantees of future performance. The factors that could cause actual results to differ materially include: interruptions or cancellation of existing contracts, inability to integrate acquisitions, impact of competitive products and pricing, product demand and market acceptance risks, the presence of competitors with greater financial resources than the Company, product development and commercialization risks, changes in governmental regulations, and changing economic conditions in developing countries and an inability to arrange additional debt or equity financing. More information about factors that potentially could affect the Company's financial results is included in the Company's filings with the Securities and Exchange Commission, including its Annual Report on Form 10-K for the year ended December 31, 2009, Amendment No. 1 to the Company's Annual Report on Form 10-K and the Company's Current Reports on form 8-K and 8-K/A filed in connection with its acquisition of ValidSoft.*



The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and notes thereto and the other financial information included elsewhere in this document.

## **Overview**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our financial statements and notes thereto and the other financial information included elsewhere in this document.

## **Services and Solutions**

### *Full-MVNE/MVNO Mobile Services – wholesale services and managed services*

As of 2007, we positioned ourselves as an MVNE to MNOs and MVNOs offering a wide range of mobile enabling/enhancing services through sophisticated, proprietary technology supported by multi-country operations with a focus on business to business, outsourcing /partnering strategy. Important milestones in this respect are:

- On September 17, 2008 a hosting agreement was signed between T-Mobile Netherlands BV and Elephant Talk Holding AG, a 100% affiliate of Elephant Talk Europe Holding BV. T-Mobile is one of the three MNOs in the Netherlands. Elephant Talk will, as exclusive MVNE for T-Mobile, connect MVNOs in the Netherlands to its platform, making use of the mobile network of T-Mobile.
- In June 2009 we signed a hosting agreement with Vizzavi Spain (part of Vodafone Group). Elephant Talk to be the exclusive provider to Vizzavi for MVNE services in Spain.
- Following the start of our MVNE services in the Netherlands in the fourth quarter of 2008, we have entered into heads of terms agreements with MVNOs for wholesale services in the Netherlands and have started servicing these companies while currently implementing additional ones. In Spain, we have provided since June 2009, managed services to Vizzavi (part of the Vodafone Group) and are in the process of preparing and implementing new ones.

### *Customized Mobile Solutions – integrated fraud and security solutions (ValidSoft)*

In line with our strategy to develop and market customized mobile solutions, we acquired ValidSoft on March 17, 2010. ValidSoft provides strong authentication and transaction verification capabilities that allow organizations to quickly implement solutions that protect against certain of the latest forms of credit and debit card fraud and on-line transaction and identity theft. By correlating the relative location of a person's credit card with the location of their mobile phone, this service can, for example, tell a bank or card issuer in less than half a second if the transaction is likely genuine or fraudulent. We anticipate generating revenues on a per transaction basis (per verification). This acquisition combines what we believe to be ValidSoft's best in class proprietary software with our superior telecommunication platform to create what we believe is the best integrated electronic fraud prevention solution available.

### *Landline network outsourcing services*

Through our fixed line telecom infrastructure and our centrally operated and managed IN-CRM-Billing platform, we also provide traditional telecom services like Carrier Select and Carrier Pre-Select Services, Toll Free and Premium Rate Services to the business market.

## **Support technology**

### *Telecom infrastructure & network*

We currently operate a switch-based telecom network with national licenses and direct fixed line interconnects with the Incumbents/National Telecom Operators in seven (7) European countries, one (1) in the Middle East (Bahrain), and partnerships with telecom operators in Scandinavia, Poland and Germany, and France. To this we have added mobile access coverage in order to cater for our mobile services and solutions. Our first mobile partners are T-Mobile in the Netherlands and Vizzavi (a Vodafone company) in Spain.

Through our European and Chinese development centers, we develop in-house telecom and media related systems and software, centered around two of the companies’ proprietary platforms ET BOSS and Infitel.

Electronic fraud prevention products: VALid-POS®, VALid® and VALid-VSG™.

Our recent acquisition of ValidSoft has given us ownership of technology and intellectual property to combat fraud relating to card, the internet, and telephone channels. ValidSoft solutions are marketed under VALid-POS® and VALid®. For its biometrics based product it trades under VALid-VSG™.

**Results of Operations**

Our results of operations for the six months ended June 30, 2010, consisted of the operations of Elephant Talk , its wholly-owned subsidiaries, Elephant Talk Limited and its subsidiaries, Elephant Talk Europe Holding BV and its subsidiaries, Elephant Talk Global Holding BV and its subsidiaries.

Although the vast majority of our business activities are carried out in Euros, we report our financial statements in US dollars (“USD”). The conversion of Euros to USD leads to period-to-period fluctuations in our reported USD results arising from changes in the exchange rate between the USD and the Euro. Generally, when the USD strengthens relative to the Euro, it has an unfavorable impact on our reported revenue and income and a favorable impact on our reported expenses. Conversely, when the USD weakens relative to the Euro, it produces a favorable impact on our reported revenue and income, and an unfavorable impact on our reported expenses. The above fluctuations in the USD/Euro exchange rate therefore result in currency translation effects (not to be confused with real currency exchange effects), which impact our reported USD results and may make it difficult to determine actual increases and decreases in our revenue and expenses which are attributable to our actual operating activities. In addition to reporting changes in our financial statements in USD’s as per the requirements of United States generally accepted accounting principles, we also highlight the impact of any material currency translation effect by providing a comparison between periods on a constant currency basis, where the most recent USD/Euro exchange rate is applied to previous periods. Management believes that this allows for greater insight into the trends and changes in our business for the reported periods. Also, since we carry out our business activities primarily in Euros we do not currently engage in hedging activities.

**Three & Six Month Periods Ended June 30, 2010 compared to the Three & Six Month Periods Ended June 30, 2009**

**Revenue**

Revenue for the three months ended June 30, 2010 was \$9,673,825, a decrease of \$1,637,573 or (14.5%), compared to \$11,311,398 for the three months ended June 30, 2009. The decrease was the result of the lower sales during the period as well as the unfavorable impact of a \$650,056 currency translation effect arising from a higher USD/Euro exchange rate.

Revenue for the six months ended June 30, 2010 was \$19,617,590, a decrease of \$1,122,691 or (5.4%), compared to \$20,740,282 for the six months ended June 30, 2009. The decrease was the result of lower sales and to some extent the unfavorable impact of a \$105,351 currency translation effect arising from a higher USD/Euro exchange rate.

**Revenue - Constant currency**

The decrease in the first six months of 2010 revenue of \$1,017,341 over the first six months of 2009, in constant currency, was attributable to an increase in our other landline services of \$24,469 and a decline in our premium rate services (“PRS”) of (\$408,148), Mobile revenue of (\$528,979) and Middle East pre-paid calling cards revenue of (\$104,682) compared to the same period in 2009. The lower mobile revenue was the result of a customer in financial disarray leaving our Company.

revenue	June 30, 2010	June 30, 2009 constant currency	variance 2010 v 2009 constant currency
Premium Rate Services	\$ 16,945,621	\$ 17,353,796	\$ -408,148
Mobile Services	1,651,132	2,180,112	-528,979
Middle East Calling Cards	498,243	602,926	-104,682
Other revenue	522,594	498,126	24,469
<b>Total Revenue</b>	<b>\$ 19,617,590</b>	<b>\$ 20,634,931</b>	<b>\$ -1,017,341</b>

### **Cost of service**

Cost of service includes origination, termination, network and billing charges from telecommunications operators, out payment costs to content and information providers, network costs, data center costs, facility cost of hosting network and equipment and cost in providing resale arrangements with long distance service providers, cost of leasing transmission facilities, international gateway switches for voice, and data transmission services.

Cost of service for the three months ended June 30, 2010 was \$9,005,394, a decrease of \$1,626,811 (or 15.3%), compared to \$10,632,205 for the three months ended June 30, 2009. The decrease in cost of service was the result of lower sales volumes and a favorable impact of a \$620,097 currency translation effect arising from a higher USD/Euro exchange rate.

Cost of service for the six months ended June 30, 2010 was \$18,379,282, a decrease of \$1,400,720 (or 7.1%), compared to \$19,780,001 for the six months ended June 30, 2009. The decrease in cost of service was the result of lower sales volumes and a favorable impact of a \$100,710 currency translation effect arising from a higher USD/Euro exchange rate.

#### **Cost of service – constant currency**

In constant currency, the cost of service for the first three months of 2010 decreased by \$987,516 (or 9.7%) compared to the same period in 2009. Cost of service, as a percent of revenue, expressed in constant dollar terms was 93.2% and 94% for the three-month period ended June 30, 2010 and 2009, respectively.

In constant currency, the cost of service for the first six months of 2010 decreased by \$1,300,010 (or 6.6%) compared to the same period in 2009. Cost of service, as a percent of revenue, expressed in constant dollar terms was 93.7% and 95.4% for the six-month periods ended June 30, 2010 and 2009, respectively.

The decrease in cost of services is primarily the result of lower levels of PRS revenue and Mobile revenues on a constant currency basis.

Management expects cost of service will continue to decline as a percent of revenue as a greater proportion of future revenue is comprised of our mobile services and ValidSoft solutions, which have a substantially lower cost of service than our traditional PRS business.

### **Selling, general and administrative**

Selling, general and administrative (“SG&A”) expense for the three months ended June 30, 2010 was \$2,079,361, an increase of \$295,566 or 16.6 % compared to \$1,783,795 for the same period in 2009.

For the six months ended June 30, 2010, SG&A expense was \$ 3,984,709, an increase of \$737,766 or 24.8%, compared to \$3,246,943 in the same period in 2009.

#### **Selling, general and administrative – constant currency**

In constant currency, total SG&A for the three months ended June 30, 2010 increased by \$387,595 or 22.1% compared to the same period in 2009. The increase in expenses was mainly attributable to an increase in legal, accounting and public relations costs, funding and the consolidation of the ValidSoft expenses in the second quarter of 2010.

In constant currency, total SG&A for the six months ended June 30, 2010 increased with \$ 749,347 or 23.2 % compared to the same period in 2009. The increase in expenses was mainly attributable to an increase in legal, accounting and public relations costs, funding and the consolidation of the ValidSoft expenses in the second quarter of 2010.

### **Non-cash compensation to officers, directors and employees**

Non-cash compensation for the three and six months ended June 30, 2010, was \$2,712,756 and \$3,253,669, respectively, compared to \$750,406 and \$1,019,866, for the corresponding 2009 periods. The increase in both periods is primarily attributable to the restricted stock issuance in lieu of cash compensation for management salaries and board compensation (including a new board and a new management team member), higher staffing levels due to the acquisition of ValidSoft and options granted under the 2008 Incentive Plan to employees and consultants.

### ***Depreciation and amortization***

Depreciation and amortization for the three and six months ended June 30, 2010, was \$1,515,428 and \$2,360,122, respectively, compared to \$707,763 and \$1,337,945 for the comparable periods in 2009.

Depreciation and amortization expenses increased due to the consolidation into our financials as of 1 April 2010 of the amortization of \$792,751 for the ValidSoft intangibles assets.

### ***Other Income and Expenses***

Interest income for the three months ended June 30, 2010 was \$32,520 compared to \$12,237 for the same period in 2009. Interest income was \$65,119 and \$22,307 for the six months ended June 30, 2010 and 2009 respectively.

For the three months ended June 30, 2010, interest expense was \$535,887 compared to \$136,154 in 2009. Interest expense was \$982,427 and \$207,939, for the six months ended June 30, 2010 and 2009, respectively.

For the three months ended June 30, 2010, the fair value expenses and amortizations related to the Notes, associated Warrants and deferred financing costs were \$8,213,459 compared to \$0 in 2009. The fair value expenses and amortizations related to the Notes, associated Warrants and deferred financing costs were \$17,416,136 and \$0, for the six months ended June 30, 2010 and 2009, respectively.

### ***Non-controlling Interest***

Our majority owned subsidiaries are Elephant Talk Communications PRS U.K. Limited, Elephant Talk Communications Premium Rate Services Netherlands B.V., Elephant Talk Middle East & Africa (Holding) W.L.L., Elephant Talk Middle East & Africa (Holding) Jordan L.L.C., Elephant Talk Middle East & Africa Bahrain W.L.L., Elephant Talk Middle East & Africa FZ-LLC and ET-UTS NV.

During the three and six months ended June 30, 2010, we incurred a non-controlling interest charge of \$1,785 and \$2,283 respectively. During the same period in 2009, we incurred losses of \$653 and \$756 attributable to minority shareholders' interest.

### ***Comprehensive Income (Loss)***

We record foreign currency translation gains and losses as comprehensive income or loss. Comprehensive Income (Loss) for the first six months ended June 30, 2010 and 2009 was (\$3,690,746) and (\$197,259) respectively. This change is primarily attributable to the translation effect resulting from the substantial fluctuations in the USD/Euro exchange rates.

### ***Adjusted EBITDA***

We employ Adjusted EBITDA, defined as earnings before derivative accounting, such as warrant liabilities and conversion feature expensing, income taxes, depreciation and amortization and stock-based compensation, for several purposes, including as a measure of our operating performance. We use Adjusted EBITDA because it removes the impact of items not directly resulting from our core operations, thus allowing us to better assess whether the elements of our growth strategy are yielding positive results.

A reconciliation of Adjusted EBITDA to net loss, the most directly comparable measure under U.S. GAAP, for each of the fiscal periods indicated, is as follows:

	<b>Six months ended June, 30</b>		
	<b>2010</b> <b>(unaudited)</b>	<b>2009</b> <b>(unaudited)</b>	<b>2009 in</b> <b>constant</b> <b>currency</b> <b>(unaudited)</b>
Net loss	\$ (26,696,719)	\$ (4,831,661)	\$ (4,817,530)
Provision for income taxes	800	800	800
Net loss attributable to noncontrolling interest	2,283	756	756
Depreciation and amortization	2,360,122	1,337,945	1,332,175
Stock-based compensation	3,253,669	1,019,866	1,019,866
Other expenses	18,333,444	185,632	184,211
<b>Adjusted EBITDA</b>	<b>\$ (2,746,401)</b>	<b>\$ (2,286,662)</b>	<b>\$ (2,279,722)</b>

#### **Liquidity and Capital Resources**

We have an accumulated deficit of \$89,030,994 including a net loss of \$26,696,719 for the six months ended June 30, 2010.

In the first half year of 2010 the Company received loans in the total amount of €1,850,000 (US \$2,513,195) from QAT. We also raised \$2,885,000 in the Bridge Financing.

In connection with the first closing of the 2010 Private Placement Offering, we sold units having an aggregate value of \$6,459,800. Excluding the second closing of the 2010 Private Placement Offering (described in Note 26-Subsequent Events), we have raised gross proceeds of approximately \$11.9 million in 2010, resulting in net proceeds to us of approximately \$10.7 million

We believe that our cash balance at June 30, 2010, in combination with the additional funding received so far in 2010 and cash generated from operations, and commitments for additional funding will provide sufficient funds at least to the beginning of the next year.

In light of the need to raise additional funds in the immediate short term, we are focused on capital raising activities, in addition to continuing to control operating costs and aggressively managing working capital. We are actively seeking to raise additional debt or equity financing in order to fund our cash requirements generated by future operations, capital expenditures and potential acquisitions.

Although the Company has previously been able to raise capital as needed, such capital may not continue to be available at all, or if available, on reasonable terms. Further, the terms of such financing may be dilutive to existing shareholders or otherwise on terms not favorable to the Company or existing shareholders. The current global financial situation may offer additional challenges to raising the required capital. If we are unable to secure additional capital, as circumstances require, or do not succeed in meeting our sales objectives we may not be able to continue operations. As of June 2010, these conditions raised substantial doubt from our auditors as to our ability to continue as a going concern.

Our financial statements assume that we will continue as a going concern. If we are unable to continue as a going concern, we may be unable to realize our assets and discharge our liabilities in the normal course of business. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that may be necessary should we be unable to continue as a going concern.

#### **Operating activities**

Net cash used in operating activities for the six months ended June 30, 2010 was \$6,841,983 compared to \$3,063,154 in the first quarter of 2009, an increase of \$3,778,829. This increase is primarily attributable to expenses related to the consolidation of ValidSoft as of April 1, 2010 and substantial reduction in accounts payable.

### ***Investment activities***

Net cash used in investment activities for the six months ended June 30, 2010 was \$1,165,689 a decrease of \$1,143,433 (or 50%) compared to \$2,309,122 in the first half year of 2009. The increase was primarily attributable to less purchase of equipment and the elimination of the loans to ValidSoft.

### ***Financing activities***

Net cash received by financing activities for the six months ended June 30, 2010 was \$10,499,317. Please see footnotes 2 and 26 for more information.

As a result of the above activities, the Company had a cash and cash equivalents balance of \$4,276,714 as of June 30, 2010, a net increase in cash and cash equivalents of \$2,818,814, for the six months ended June 30, 2010.

### **Application of Critical Accounting Policies and Estimates**

#### ***Revenue Recognition and Deferred Revenue***

The Company's revenue recognition policies are in compliance with ASC 605, Revenue Recognition ("ASC 605") (formerly, Staff Accounting Bulletin (SAB) 104). Revenue is recognized only when the price is fixed or determinable, persuasive evidence of arrangement exists, the service is performed and the collectability of the resulting receivable is reasonably assured. The Company derives revenue from activities as a fixed-line and mobile services provider with its network and its own switching technology. Revenue represents amounts earned for telecommunication services provided to customers (net of value added tax and inter-company revenue). The Company recognizes revenue from prepaid calling cards as the services are provided. Payments received before all of the relevant criteria for revenue recognition are satisfied are recorded as deferred revenue. Deferred revenue represents amounts received from the customers against future sales of services since the Company recognizes revenue upon performing the services.

#### ***Stock-based Compensation***

Effective January 1, 2006, we adopted the provisions of ASC 718 "Compensation-Stock Compensation," ("ASC 718") (formerly SFAS No. 123(R)), using the prospective approach. As a result, we recognize stock-based compensation expense for only those awards that are granted subsequent to December 31, 2005 and any previously existing awards that are subject to variable accounting, including certain stock options that were exercised with notes in 2003, until the awards are exercised, forfeited, or contractually expire in accordance with the prospective method and the transition rules of ASC 718. Under ASC 718, stock-based awards granted after December 31, 2005, are recorded at fair value as of the grant date and recognized as expense over the employee's requisite service period (the vesting period, generally three years), which we have elected to amortize on a straight-line basis.

#### ***Business Combinations***

We use the purchase method of accounting for business combinations and the results of the acquired businesses are included in the income statement from the date of acquisition. The purchase price includes the direct costs of the acquisition. However, beginning in fiscal 2009, acquisition-related costs will be expensed as incurred, in accordance with Financial Accounting Standards Board (FASB) issued revision to Statement of Financial Accounting Standards No. 141R, "Business Combinations". Amounts allocated to intangible assets are amortized over their estimated useful lives; no amounts are allocated to in-progress research and development. Goodwill represents the excess of consideration paid over the net identifiable business assets acquired.

#### ***Intangible Assets and Impairment of long Lived Assets***

In accordance with ASC 350 (formerly SFAS No. 142), intangible assets are carried at cost less accumulated amortization and impairment charges. Intangible assets are amortized on a straight-line basis over the expected useful lives of the assets, between three and ten years. Other intangible assets are reviewed for impairment in accordance with ASC 360, "Property, Plant, and Equipment" (formerly SFAS No. 144), annually, or whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Measurement of any impairment loss for long-lived assets and identifiable intangible assets that management expects to hold and use is based on the amount of the carrying value that exceeds the fair value of the asset.

### **Impact of Accounting Pronouncements**

In April 2009, the FASB issued guidance, which is now part of ASC 825, “Interim Disclosures about Fair Value of Financial Instruments” (“ASC 825”) (formerly Financial Staff Position SFAS 107-1 and Accounting Principles Board (APB) Opinion No. 28-1). ASC 825 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, Interim Financial Reporting, to require those disclosures in summarized financial information at interim reporting periods. ASC 825 is effective for interim and annual reporting periods ending after June 15, 2009. The adoption of ASC 825 did not have an impact on the Company’s consolidated financial statements.

In May 2009, the FASB issued new guidance for accounting for subsequent events. The new guidance, which is now part of ASC 855-10, “Subsequent Events” (“ASC 855-10”) (formerly, SFAS No. 165) is consistent with existing auditing standards in defining subsequent events as events or transactions that occur after the balance sheet date but before the financial statements are issued or are available to be issued, but it also requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. The new guidance defines two types of subsequent events: “recognized subsequent events” and “non-recognized subsequent events.” Recognized subsequent events provide additional evidence about conditions that existed at the balance sheet date and must be reflected in the company’s financial statements. Non-recognized subsequent events provide evidence about conditions that arose after the balance sheet date and are not reflected in the financial statements of a company. Certain non-recognized subsequent events may require disclosure to prevent the financial statements from being misleading. The new guidance was effective on a prospective basis for interim or annual periods ending after June 15, 2009. We adopted the provisions of ASC 855-10 as required.

In June 2009, the FASB issued new guidance which is now part of ASC 105-10, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles” (ASC 105-10) (formerly Statement of Financial Accounting Standards No. 168), which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles. ASC 105-10 is effective for interim and annual periods ending after September 15, 2009. The adoption of ASC 105-10 did not have a material impact on the Company’s consolidated financial statements.

### **Item 3. Quantitative and Qualitative Disclosure About Market Risks**

Not applicable.

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

#### *Evaluation of Disclosure Controls and Procedures*

Under the supervision and with the participation of our management, including our chief executive officer and our chief financial officer, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on the foregoing, our chief executive officer and our chief financial officer concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this quarterly report due to the significant deficiencies described below.

Our management has identified a material weakness in our disclosure controls and procedures due to a lack of personnel and technological resources. This material weakness restricts our ability to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to management and that information is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is accumulated and communicated to management, including our chief executive officer and chief financial officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

#### *Changes in Internal Control over Financial Reporting*

There have not been any other changes in our internal control over financial reporting during the half year ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

#### **(a) Rescission of the Purchase Agreement of May 24, 2004 of New Times Navigation Limited.**

As previously described in our 2004 Annual Report we and New Times Navigation Limited mutually agreed to terminate this purchase agreement. We returned the received shares of New Times Navigation Limited to the concerned shareholders and received back 90,100 of our common stock out of the 204,000 issued by us for the purchase. In addition we issued 37 unsecured convertible promissory notes for a total amount of \$3,600,000. On our request 21 notes were returned with a total value of \$2,040,000.

We are presently seeking relief from the High Court of the Hong Kong Special Administrative Region against the holders of the unreturned shares to return a total of 113,900 common shares (valued at \$381,565) and also to have them return the remaining 18 unsecured convertible promissory notes representing a total amount of \$1,740,000 and rescind the purchase agreement. The case is currently pending.

#### **(b) Manu Ohri Litigation**

On March 26, 2009, an action was commenced against the Company by Manu Ohri ("Ohri"), our former Chief Financial Officer, in the California Superior Court, Orange County, in a matter entitled Manu Ohri v. Elephant Talk Communications, Inc., Case No. 30-20009-00120609. Ohri alleges breach of a written contract, breach of an oral contract, and a common count for services rendered. Ohri claims, among other things, \$427,816 in unpaid severance payments, \$56,951 owed under an oral consulting agreement, and stock options payable under the oral consulting agreement with a net value of \$622,000. The Company denies all material allegations of Ohri's complaint and asserts various affirmative defenses. The Company also filed and served a cross-complaint against Ohri, who then filed and served an answer, denying the material allegations of the Company's cross-complaint.

The parties are engaged in pretrial discovery, and a jury trial is scheduled to start December 6, 2010.

#### **(c) Bruce Barren Litigation**

On December 30, 2009, an action was commenced against the Company by Bruce Barren ("Barren"), a former director of the Company from January 2008 to May 2009, in the California Superior Court, Los Angeles County, in a matter entitled Bruce Barren v. Elephant Talk Communications, Inc., Case No. BC429032. Barren alleges causes of action for breach of a restricted stock agreement, breach of the implied covenant of good faith and fair dealing, breach of an oral employment agreement, and common counts for services rendered—despite entering into a settlement agreement and full release of any claims against the Company shortly after his resignation in May 2009. The Company contends that Mr. Barren's claims are without merit, and has answered his complaint, denying all material allegations and asserting various affirmative defenses.

The parties are engaged in pretrial discovery, and a jury trial is scheduled to start February 7, 2011.



#### **(d) Chong Hing Bank Litigation**

On December 15, 2009, an action was commenced against the Company by Chong Hing Bank Limited, fka Liu Chong Hing Bank Limited, a publicly listed Hong Kong company (the "Bank"), in the California Superior Court, Orange County, in a matter entitled Chong Hing Bank Limited v. Elephant Talk Communications, Inc., Case No. 30-2009-00328467. The Bank alleges that it entered into various installment loan agreements and an overdraft account with Elephant Talk Limited ("ETL"), a Hong Kong subsidiary of the Company. The Bank alleges that ETL is in default on the loans and overdraft account, and that \$1,536,792.28 plus interest is currently due. The Bank alleges that the Company is liable to repay the loans and overdraft account. The Bank is suing the Company for breach of contract and common counts. The Company has answered the complaint, denying all material allegations and asserting various affirmative defenses.

The parties are engaged in pretrial discovery, and a jury trial is scheduled to start February 14, 2011.

#### **Item 1a. Risk Factors**

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the Risk Factors included in Part I, "Item 1A. — "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2009, and the additional, if any, Risk Factors set forth below. These Risk Factors could materially impact our business, financial condition and/or operating results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely impact our business, financial condition and/or operating results.

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

##### **Bridge Security Purchase Agreement**

In May 2010 we sold 2,885,000 of units at a purchase price of \$1.00 per unit, with each unit consisting of one share of our restricted common stock and two warrants to accredited, United States and foreign investors (including affiliates of the Company) in transactions exempt from registration under the Securities Act pursuant to Section 4(2), Regulation D and Regulation S (the "Sales"). In connection with the Sales, the purchasers received (i) warrants to purchase up to 2,885,000 of shares of our common stock, at an exercise price of \$1.25 per share and (ii) warrants to purchase up to 2,885,000 of shares of our common stock, at an exercise price of \$2.00 per share. None of the warrants contain cashless exercise provisions. Each warrant contains standard anti-dilution protection and may be cancelled upon the occurrence of the following: (i) with respect to the \$1.25 warrant, in the event that the average of the last closing sale price of the common stock on the OTC Bulletin Board, or a national securities exchange, trading market or inter-dealer electronic quotation system, exceeds \$3.00 for twenty consecutive trading days and the holder fails to exercise within fifteen days of receipt of notice this target was met, the warrants will expire worthless and (ii) with respect to the \$2.00 warrant, in the event that the average of the last closing sale price of the common stock on the OTC Bulletin Board, or a national securities exchange, trading market or inter-dealer electronic quotation system, exceeds \$4.00 for twenty consecutive trading days and the holder fails to exercise within fifteen days of receipt of notice this target was met, the warrants will expire worthless.

##### **Private Placement 2010**

On June 28, 2010, we consummated the first closing of the 2010 Private Placement Offering. In connection with the first closing, we sold units having an aggregate value of \$6,459,800 to accredited investors. At a price of \$1.20 per unit, we delivered shares of common stock in the amount of 5,383,175 and warrants to purchase an aggregate of 5,383,175 shares of common stock at a purchase price of \$1.20 per share, rounding up to account for any fractional shares. We intend to use the net proceeds from the Offering primarily for working capital. The units were offered and sold pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933, as amended.

The warrants issued as part of the units included in the 2010 Private Placement Offering entitle the holder to purchase shares of our common stock for a period of five years from the date of issuance and contain certain anti-dilution rights. In the event (i) the trading price of the common stock exceeds \$2.25 for twenty (20) consecutive trading days and (ii) there is an effective registration statement with a current prospectus on file with the Securities and Exchange Commission, we have the option to redeem the warrants.

The Company is obligated to register the common stock underlying the units and warrants on a registration statement to be filed after the final closing of the 2010 Private Placement Offering. In addition, the investors in the 2010 Private Placement Offering are entitled to unlimited piggy-back registration rights.

In addition to the above issuances, during the three months ending June 30, 2010, we issued an aggregate of 1,671,767 shares to various parties for (i) services provided and (ii) with respect to contingent condition due pursuant to a stock purchase agreement. We received no proceeds from the issuance of these securities.

The above-referenced securities were offered and sold pursuant to exemptions from registration provided by the Securities Act.

**Item 3. Defaults upon Senior Securities.**

None.

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

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

(a) Exhibits

- 31.1 Certification of the CEO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) on page X-1.
- 31.2 Certification of the CFO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a) on page X-2.
- 32.1 Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 on page X-3.
- 32.2 Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 on page X-4.

**SIGNATURES**

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

**ELEPHANT TALK COMMUNICATIONS, INC.**

August 16, 2010

By /s/ Steven van der Velden  
Steven van der Velden  
President and Chief Executive Officer  
(Principal Executive Officer)

August 16, 2010

By /s/ Mark Nije  
Mark Nije  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

**Index to Exhibits**

<b>Number</b>	<b>Exhibit</b>	<b>Page</b>
31.1	Certification of the CEO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a)	X-1
31.2	Certification of the CFO pursuant to Rule 13a-14(a) or Rule 15(d)-14(a)	X-2
32.1	Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X-3
32.2	Certification pursuant to 18 U.S.C. §1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X-4

**Certification of Chief Executive Officer**

**Pursuant to Rule 13a-14(a)**

I, Steven van der Velden, certify that:

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

Date: August 16, 2010

/s/ Steven van der Velden  
Steven van der Velden  
President and Chief Executive Officer

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**Certification of Chief Financial Officer**

**Pursuant to Rule 13a-14(a)**

I, Mark Nije, certify that:

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

Date: August 16, 2010

/s/ Mark Nije  
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Mark Nije  
Chief Financial Officer

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**ELEPHANT TALK COMMUNICATIONS, INC.**

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Elephant Talk Communications, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven van der Velden, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss.1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Steven van der Velden

Steven van der Velden

President and Chief Executive Officer

August 16, 2010

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**ELEPHANT TALK COMMUNICATIONS, INC.**  
**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO**  
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Elephant Talk Communications, Inc. (the "Company") on Form 10-Q for the period ending June 10, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark Nije, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss.1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Mark Nije  
Mark Nije  
Chief Financial Officer  
August 16, 2010

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