

Trinsic, Inc.
Form 10-Q
August 08, 2006

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

(MARK ONE)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER: 000-28467
TRINSIC, INC.**

(Exact name of Registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

59-3501119
(I.R.S. Employer
Identification Number)

**601 SOUTH HARBOUR ISLAND BOULEVARD, SUITE 220
TAMPA, FLORIDA 33602
(813) 273-6261**

(Address, including zip code, and
telephone number including area code, of
Registrant's principal executive offices)

**SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT: NONE
SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: COMMON STOCK, PAR
VALUE \$.01 PER SHARE, PREFERRED STOCK PURCHASE RIGHTS**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (as defined in Rule 12b-2 of the Exchange Act.)

Large accelerated filer Accelerated filer Non-accelerated filer

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

Yes No

The number of shares of the Registrant's Common Stock outstanding as of August 3, 2006 was approximately 18,464,341.

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TRINSIC, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

| | (Unaudited) | |
|---|------------------|-------------------------|
| | June 30, 2006 | December 31, 2005 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 700 | \$ 79 |
| Accounts receivable, net of allowance for doubtful accounts of \$25,111 and \$20,489 | 16,160 | 13,713 |
| Prepaid expenses and other current assets | 3,719 | 4,713 |
| Total current assets | 20,579 | 18,505 |
| Property and equipment, net | 16,427 | 19,931 |
| Intangible assets, net | 8,054 | |
| Other assets | 3,159 | 2,884 |
| Total assets | \$ 48,219 | \$ 41,320 |
| Liabilities and Stockholders Deficit | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$ 45,713 | \$ 40,248 |
| Deferred revenue | 6,717 | 6,013 |
| Current portion of long-term debt and capital lease obligations | 9,040 | 2,418 |
| Total current liabilities | 61,470 | 48,679 |
| Long-term debt and capital lease obligations | 684 | 1,025 |
| Total liabilities | 62,154 | 49,704 |
| Commitments and contingencies (Notes 6, 8, 11 and 13) | | |
| Stockholders deficit: | | |
| Common stock, \$0.01 par value; 150,000,000 shares authorized; 18,762,994 and 17,756,944 shares issued; 18,457,510 and 17,518,573 outstanding | 185 | 175 |
| Unearned stock compensation | (415) | (360) |
| Additional paid-in capital | 417,037 | 416,127 |
| Accumulated deficit | (430,737) | (424,321) |
| Treasury stock, 305,484 and 238,371 shares at cost | (5) | (5) |

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| | | |
|---|-----------|-----------|
| Total stockholders' deficit | (13,935) | (8,384) |
| Total liabilities and stockholders' deficit | \$ 48,219 | \$ 41,320 |

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

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TRINSIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Revenues | \$ 43,878 | \$ 50,797 | \$ 87,734 | \$ 107,928 |
| Operating expenses: | | | | |
| Network operations, exclusive of depreciation and amortization shown below | 28,158 | 26,999 | 52,985 | 56,833 |
| Sales and marketing | 1,065 | 3,692 | 2,672 | 8,911 |
| General and administrative | 12,455 | 19,025 | 29,165 | 41,535 |
| Depreciation and amortization | 4,193 | 2,955 | 7,176 | 7,134 |
| Total operating expenses | 45,871 | 52,671 | 91,998 | 114,413 |
| Operating loss | (1,993) | (1,874) | (4,264) | (6,485) |
| Nonoperating income (expense): | | | | |
| Interest and other income | 1,117 | 490 | 2,042 | 7,293 |
| Interest and other expense | (1,919) | (1,873) | (4,194) | (3,626) |
| Total nonoperating income (expense) | (802) | (1,383) | (2,152) | 3,667 |
| Net loss | \$ (2,795) | \$ (3,257) | \$ (6,416) | \$ (2,818) |
| Weighted average shares outstanding | 18,451,371 | 5,533,564 | 17,994,581 | 5,526,088 |
| Basic and diluted net loss per share | \$ (0.15) | \$ (0.59) | \$ (0.36) | \$ (0.51) |

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

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TRINSIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(In thousands)

| | Six Months Ended | |
|---|-------------------------|-------------|
| | June 30, | |
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net loss | \$ (6,416) | \$ (2,818) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 7,176 | 7,134 |
| Provision for bad debts | 5,370 | 6,384 |
| Gain on sale of building | 97 | |
| Expense charged for granting of restricted stock | 865 | 93 |
| Change in operating assets and liabilities: | | |
| Increase in accounts receivable | (7,817) | (2,513) |
| Increase in prepaid expenses | (355) | (2,020) |
| Increase in other assets | (275) | (628) |
| Increase (decrease) in accounts payable and accrued liabilities | 5,465 | (5,352) |
| Increase in deferred revenue | 704 | 244 |
| Total adjustments | 11,230 | 3,342 |
| Net cash provided by operating activities | 4,814 | 524 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (1,053) | (1,633) |
| Purchase of customer lists | (1,727) | |
| Net cash used in investing activities | (2,780) | (1,633) |
| Cash flows from financing activities: | | |
| Payments on long-term debt and capital lease obligations | (925) | (534) |
| Proceeds from sale of building | 400 | |
| Principal repayments received on notes receivable issued for stock | | 250 |
| Payments on note payable for customer lists | (1,865) | |
| Payoff of asset based loan | | (12,934) |
| Proceeds from stand by credit facility | 977 | 13,500 |
| Net cash provided by financing activities | (1,413) | 282 |
| Net increase (decrease) in cash and cash equivalents | 621 | (827) |
| Cash and cash equivalents, beginning of period | 79 | 1,363 |

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| | | |
|---|----------|--------|
| Cash and cash equivalents, end of period | \$ 700 | \$ 536 |
| Non-cash investing and financing activities: | | |
| Purchase of customer lists | \$ 6,229 | \$ |

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

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**TRINSIC, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)**

(ALL TABLES ARE IN THOUSANDS, EXCEPT FOR SHARE AND PER SHARE DATA)

1. NATURE OF BUSINESS

DESCRIPTION OF BUSINESS

Trinsic, Inc. (formerly Z-Tel Technologies, Inc.) and subsidiaries (Trinsic, we, us or our) is a provider of residential and business telecommunications services. We offer local and long distance telephone services in combination with enhanced communications features accessible through the telephone, the Internet and certain personal digital assistants. In 2004 we began offering services utilizing Internet protocol, often referred to as IP telephony, voice over Internet protocol or VoIP.

LIQUIDITY AND CAPITAL RESOURCES

Our inability to operate profitably and to consistently generate cash flows from operations and our reliance therefore on external funding either from loans or equity raise substantial doubt about our ability to continue as a going concern. The accompanying consolidated financial statements were prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The realization of assets and the satisfaction of liabilities in the normal course of business is dependent upon, among other things, our ability to operate profitably, to generate cash flow from operations and to obtain funding adequate to fund its business.

Our operations are subject to certain risks and uncertainties, particularly related to the evolution of the regulatory environment, which impacts our access to and cost of the network elements that we utilize to provide services to our customers.

We have incurred significant losses since our inception as a result of developing our business, performing ongoing research and development, building and maintaining our network infrastructure and technology, the sale and promotion of our services, and ongoing administrative expenditures. As of June 30, 2006, we had an accumulated deficit of approximately \$430.7 million and \$0.7 million in cash and cash equivalents. We have funded our expenditures primarily through operating revenues, private securities offerings, our asset based loan, our standby credit facility, a sale-leaseback credit facility, an accounts receivable factoring facility and an initial public offering. For the six months ended June 30, 2006, net cash provided by operating activities was \$4.8 million as compared to \$0.5 million for the same period in the prior year.

On April 4, 2005, we entered into an accounts receivable financing agreement with Thermo Credit, LLC (Thermo). The agreement provides for the sale of up to \$33 million of our accounts receivable on a continuous basis to Thermo, subject to selection criteria as defined in the contract.

On December 15, 2005, we borrowed \$1.0 million from the 1818 Fund III, L.P. (the Fund) in order to take advantage of a tax settlement with the State of New York. On January 12, 2006, we borrowed \$1.0 million from the Fund for general corporate purposes. In connection with the loan, and the previous \$1,000,000 loan received December 15, 2005, we delivered to the Fund a promissory note bearing interest at 12% annually and due on demand and a mortgage on certain real property we own in Atmore, Alabama where we have an operations center. Under the promissory note we may be required to grant additional security to the Fund.

Our net cash used in investing activities was \$2.8 million for the six months ended June 30, 2006, compared to \$1.6 million for the same period in the prior year. The increase was attributable to purchasing local access lines from Sprint in 2006.

For the six months ended June 30, 2006, net cash provided by financing activities was \$1.4 million as compared to \$0.3 million for the same period in 2005. This increase in 2006 is primarily the result of the money borrowed from the Fund,, the sale of a building mentioned in Note 6 and the purchase of local access lines from Sprint.

Over the course of the first five months in 2006, we acquired 111,697 UNE-P local access lines from Sprint for which we previously provided services on a wholesale basis. We acquired the lines pursuant to a definitive agreement dated October 25, 2005. Under the agreement we purchased the lines for \$11.2 million, \$4.9 million of which has been paid as of June 30, 2006. The total purchase price includes \$1.3 million that was escrowed during the latter part of 2005. The remaining purchase price will be paid in monthly installments through July 2007. As a result of this transaction

with Sprint, we will no longer have any wholesale lines subsequent to second quarter 2006.

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On February 13, 2006, we entered into a definitive agreement to sell approximately 43,000 local access lines to Access Integrated Networks, Inc., a privately-held telephone company headquartered in Macon, Georgia. The lines represent substantially all of our residential and small business lines within BellSouth territories, including Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina and Tennessee. Lines serving multi-unit enterprises were excluded from the sale. The total purchase price will depend upon the number of lines in service at the time of closing. As of August 1, 2006, we had approximately 29,000 lines in service to be included in this sale. In addition, Access Integrated Networks agreed to utilize our voicemail platform for at least one year after the sale. We expect this sale to close during the third quarter.

On March 3, 2006 we initiated a reduction in force which terminated the employment of approximately 118 employees. All post termination wages and salaries were paid out as of April 7, 2006. In association with the reduction in force we have ceased actively marketing our IP telephony services. Services to our current IP telephony customers will be unaffected.

In June 2006, we sold a building to a related party for cash proceeds of \$0.4 million. The proceeds were used to payoff our note payable to Corman Elegg and to make a small principal paydown on our \$2 million loan from the Fund mentioned above. We recorded a \$0.1 million loss associated with the sale.

Effective July 27, 2006, we finalized a settlement with an ILEC over disputed balances that will reduce our net accounts payable balance by \$12.1 million. We paid a total of \$3.9 million, \$0.5 million of which had been paid as of June 30, 2006. The remainder was paid in July 2006. The settlement, which was contingent upon final payment of the full \$3.9 million, will result in a net gain of approximately \$8.2 million that will be reflected in our third quarter statement of operations.

2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by us in accordance with accounting principles generally accepted in the United States of America for interim financial information and are in the form prescribed by the Securities and Exchange Commission's (SEC) instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes for complete financial statements as required by accounting principles generally accepted in the United States of America. The interim unaudited financial statements should be read in conjunction with our audited financial statements as of and for the year ended December 31, 2005, included in our Annual Report on Form 10-K filed with the SEC on March 31, 2006. In the opinion of management, all adjustments considered necessary for a fair statement have been included. Operating results for the quarter and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

RECLASSIFICATION

Certain amounts in the consolidated statements of operations for the three and six months ended June 30, 2005 have been reclassified to conform to the presentation for the three and six months ended June 30, 2006.

3. SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

(a) Significant Accounting Policies

Our significant accounting policies are included in the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2005. There have been no changes to our significant accounting policies during 2006.

Consistent with our significant accounting policies referenced above, prepaid expenses and other current assets includes restricted certificates of deposits with various maturity dates ranging from December 2006 to April 2007 in the amount of \$2.4 million as of each balance sheet date presented.

(b) Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that entities recognize the impact of a tax position in their financial statements, if that position is more likely than not to be sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We are still assessing the impact the adoption of FIN 48 will have on our financial statements.

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In March 2006, FASB issued Statement of Financial Accounting Standards (SFAS) No. 156, Accounting for Servicing of Financial Assets (SFAS No. 156), which amends SFAS No. 140. SFAS 156 provides guidance addressing the recognition and measurement of separately recognized servicing assets and liabilities, common with mortgage securitization activities, and provides an approach to simplify efforts to obtain hedge accounting treatment. SFAS 156 is effective for all separately recognized servicing assets

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and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006, with early adoption being permitted. We are still assessing the impact that the adoption of SFAS No. 156 will have on our financial position, results of operations and cash flows.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS 155), which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140). SFAS 155 provides guidance to simplify the accounting for certain hybrid instruments by permitting fair value remeasurement for any hybrid financial instrument that contains an embedded derivative and clarifies that beneficial interests in securitized financial assets are subject to SFAS 133. SFAS 155 is effective for all financial instruments acquired, issued or subject to a new basis occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. We do not anticipate that the adoption of SFAS No. 155 will have a material impact on our financial position, results of operations or cash flows.

4. ACCOUNTS RECEIVABLE FINANCING AGREEMENT

On April 4, 2005, we entered into an accounts receivable financing agreement with Thermo Credit, LLC (Thermo). The agreement provides for the sale of up to \$22 million of our accounts receivable on a continuous basis to Thermo, subject to selection criteria as defined in the contract.

During October 2005, we signed an amendment to our accounts receivable financing agreement with Thermo. The amendment increases the amount of accounts receivable that we can sell to Thermo from \$22 million to \$26 million, subject to selection criteria as defined in the original contract. The discount rate also increases from 2.5% to 2.75%. On February 1, 2006, we amended our accounts receivable financing facility once more by increasing the facility to \$33 million.

We sold approximately \$111.0 million of receivables to Thermo, for net proceeds of approximately \$69.1 million, during the six months ended June 30, 2006. We have not recorded a servicing asset or liability to date, as our servicing fees under the agreement represent the amount of cash collections in excess of the amounts funded by Thermo. To date, the amount of collections from our servicing activities have approximated the amounts funded by Thermo; therefore, not giving rise to any servicing asset or liability. We recognized costs related to the agreement of approximately \$1.8 million and \$0.0 million for the three months ended June 30, 2006 and 2005, respectively. During the six months ended June 30, 2006 and 2005, we recognized \$3.4 million and \$0.0 million, respectively. We were responsible for the continued servicing of the receivables sold.

5. INTANGIBLE ASSETS

Over the course of the first five months in 2006, we acquired 111,697 UNE-P local access lines from Sprint for which we previously provided services on a wholesale basis. We acquired the lines pursuant to a definitive agreement dated October 25, 2005. Under the agreement we purchased the lines for \$11.2 million, \$4.9 million of which has been paid as of June 30, 2006. The remaining purchase price will be paid in monthly installments through July 2007. The entire purchase price has been recorded as an intangible asset.

| | June 30, 2006 | | | December 31, 2005 | | |
|--|--------------------|-----------------------------|-----------------------------|--------------------|-----------------------------|-----------------------------|
| | Carrying Amount | Accumulated Amortization | Net Intangible Assets | Carrying Amount | Accumulated Amortization | Net Intangible Assets |
| Customer related intangible assets: | | | | | | |
| Customer list from acquisition of Sprint lines | 11,170 | 3,116 | 8,054 | | | |
| | \$ 11,170 | \$ 3,116 | \$ 8,054 | \$ | \$ | \$ |

**Aggregate amortization
expense:**

| | |
|---|----------|
| For the six months ended June 30, 2006 | \$ 3,116 |
| For the six months ended June 30, 2005 | \$ 457 |
| Expected amortization expense for the years ending December 31, 2006 | \$ 6,903 |
| 2007 | \$ 1,151 |
| | 7 |

Table of Contents**6. OTHER DEBT**

On December 15, 2005, we borrowed \$1.0 million from the Fund in order to take advantage of a tax settlement with the State of New York. On January 12, 2006, we borrowed \$1.0 million from the Fund for general corporate purposes. In connection with the loan, and the previous \$1.0 million loan received December 15, 2005, we delivered to the Fund a promissory note bearing interest at 12% annually and due on demand and a mortgage on certain real property we own in Atmore, Alabama where we have an operations center. Under the promissory note we may be required to grant additional security to the Fund.

See Note 9 Related Party Transactions for information related to the payoff of the Corman Elegre note payable as well as the small principal paydown on the loan payable to the Fund.

The table below lists our current and long-term debt as of June 30, 2006 and December 31, 2005:

| | June 30, 2006 | December 31, 2005 |
|--|------------------|-------------------------|
| RELATED PARTIES: | | |
| Note payable to Corman Elegre, customer base pledged as collateral, payable in monthly installments, due September 2004, interest rate at 6% | \$ | \$ 360 |
| Loan payable to the Fund, secured by a mortgage on real property located in Atmore, AL; due on demand, interest rate at 12% | 1,977 | 1,000 |
| UNRELATED PARTIES: | | |
| Tax settlement payable to the State of New York, payable in monthly installments through March 2008, non-interest bearing | 1,505 | 2,050 |
| Purchase price for local access lines due to Sprint, payable in monthly installments through July 2007, non-interest bearing | 6,229 | |
| Capital leases | 13 | 33 |
| | \$ 9,724 | \$ 3,443 |
| Less: Current portion | (9,040) | (2,418) |
| Total long-term debt | \$ 684 | \$ 1,025 |

7. STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123R, Share-Based Payment (SFAS 123R), which revised SFAS 123, Accounting for Stock-Based Compensation (SFAS 123). SFAS 123R requires the grant-date fair value of all stock-based payment awards, including employee stock options, to be recognized as employee compensation expense over the requisite service period. We adopted SFAS 123R on January 1, 2006 and applied the modified prospective transition method. Under this transition method, we did not restate any prior periods and we are recognizing compensation expense for all stock-based payment awards that were outstanding, but not yet vested, as of January 1, 2006.

Prior to the adoption of SFAS 123R, the Company utilized the intrinsic-value based method of accounting under APB Opinion No. 25, (APB 25) Accounting for Stock Issued to Employees and related interpretations, and adopted the disclosure requirements of SFAS 123. Under the intrinsic-value based method of accounting, no compensation

expense was historically recognized in the financial statements for stock options. For additional information about our stock-based compensation and for additional disclosures required under SFAS 123R, refer to Note 20 of the Notes to Consolidated Financial Statements in our Form 10-K.

On January 20, 2006, our board of directors approved the full vesting of all of our unvested, outstanding stock options. All of the stock options were out-of-the-money and we decided to accelerate the vesting in order to avoid future administrative and other costs. As a result of this accelerated vesting, all remaining compensation costs related to our stock options was recorded in the three months ended March 31, 2006.

During the six months ended June 30, 2006, our general and administrative expense includes \$0.7 million, or \$0.04 per share, in compensation expense related to our stock-based payment awards.

As noted above, we previously accounted for our stock options under APB 25. The following table illustrates the effect on net income and earnings per share for the three and six months ended June 30, 2005, if we had applied the fair value recognition provisions of SFAS No. 123, to stock-based employee compensation. The fair value of the options granted has been estimated at the various grant dates using the Black-Scholes option-pricing model with the following assumptions:

Fair market value based on our closing common stock price on the date the option is granted;

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Expected option term of 5 years;

Volatility based on the historical stock price over a period consistent with the expected term;

No expected dividend payments on our common stock.

| | For the six months ended June 30, 2005 | For the six months ended June 30, 2005 |
|---|---|---|
| Net loss attributable to common stockholders, as reported | \$(3,257) | \$ (2,818) |
| Add: Stock based compensation included in net loss | 52 | 93 |
| Deduct: Total stock based employee compensation determined under the fair value based method for all awards | (637) | (1,279) |
| Net loss attributable to common stockholders, pro forma | \$(3,842) | \$ (4,004) |
| Basic and Diluted Net Loss per Common Share | | |
| As reported | \$ (0.59) | \$ (0.51) |
| Pro forma | \$ (0.69) | \$ (0.72) |

8. COMMITMENTS AND CONTINGENCIES

We have disputed billings and access charges from certain inter-exchange carriers (IXC) and incumbent local exchange carriers (ILECs). We contend that the invoicing and billings of these access charges are not in accordance with the interconnection, service level, or tariff agreements between us and certain IXCs and ILECs. We have not paid these disputed amounts and management believes that we will prevail in these disputes. At June 30, 2006, the total disputed amounts were approximately \$20.5 million. We have accrued for \$12.6 million, which represents the access charges that we believe are valid or that may be deemed valid. During the third quarter, our outstanding dispute balance of \$20.5 million will be reduced by \$17.2 million and our accrual of \$12.6 million will be reduced by \$11.4 million, per the settlement mentioned below in Footnote 13 Subsequent Events.

As of June 30, 2006, we have agreements with three long-distance carriers to provide transmission and termination services for all of our long distance traffic. These agreements generally provide for the resale of long distance services on a per-minute basis and contain minimum volume commitments. As a result of not fulfilling all of our volume commitments as outlined in one of these contracts, we agreed to pay an increased per minute charge for minutes until the achievement of certain minimum minute requirements. Once we meet the new agreed upon minimum minutes we will revert to the terms of our original agreement. All other terms of the original agreement continue in full force. In July 2004, we entered into an agreement with an Operations Support Systems services firm to outsource customer provisioning and other ordering through electronic bonding with the incumbent local exchange carriers. In November 2004, we renegotiated this agreement, resulting in a lowering of our monthly minimum payments for the six month time period beginning on July 1, 2005. In May 2005, we renegotiated this agreement once again, resulting in a minimum annual commitment of approximately \$2.8 million for the year ending December 31, 2006. We made payments under the agreement totaling \$0.7 million and \$0.0 million during the three months ended June 30, 2006 and 2005, respectively. We paid \$1.2 million and \$0.0 million during the six months ended June 30, 2006 and 2005, respectively.

On April 15, 2005, Trinsic entered into a Wholesale Advantage Services Agreement with Verizon Services Company on behalf of Verizon s Incumbent Local Exchange Carriers (Verizon ILECs). The Wholesale Advantage Services Agreement will act as a replacement for Trinsic s existing Interconnection Agreements for the provision of UNE-P services in Verizon service areas. As long as Trinsic meets certain volume commitments, Verizon will continue to provide a UNE-P like service at gradually increasing rates for a five year period. The contract contains a take-or-pay

clause that is applicable for every month starting in May 2005. The calculation is based on a snapshot of lines we had in service as of March 31, 2005 the baseline volume. If Trinsic is unable to replace lines generated by normal churn, this take-or-pay clause may become effective and significantly raise our cost in the Verizon footprint. In July 2006, we amended our Wholesale Advantage Services Agreement to exclude the newly acquired Sprint lines from the baseline volume. This significantly lowers our minimum volume commitments with Verizon. In exchange for the decreased minimums, we accepted a rate increase across the Verizon territory. Both the decreased volume commitment and the rate increase were effective as of January 1, 2006. We have recorded approximately \$0.6 million for the rate increase as of June 30, 2006.

9. RELATED PARTY TRANSACTIONS

We recorded interest on our related party debt of \$0.1 million and \$0.8 million during the three months ended June 30, 2006 and 2005, respectively, and we recorded interest of \$0.1 million and \$1.2 million during the six months ended June 30, 2006 and 2005, respectively.

In June 2006, we sold a building to a related party for cash proceeds of \$0.4 million. The proceeds were used to payoff our note

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payable to Corman Elegre and to make a small principal paydown on our \$2 million loan from the Fund mentioned above. We recorded a \$0.1 million loss associated with the sale.

10. COMPUTATION OF NET LOSS PER SHARE

Basic net loss per share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding during the period. Incremental shares of common stock equivalents are not included in the calculation of diluted net loss per share as the inclusion of such equivalents would be anti-dilutive.

Net loss per share is calculated as follows:

| | Three Months Ended June | | Six Months Ended June 30, | |
|--|--------------------------------|-------------|----------------------------------|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| Basic and diluted net loss per share: | | | | |
| Net loss | \$ (2,795) | \$ (3,257) | \$ (6,416) | \$ (2,818) |
| Weighted average shares outstanding: | 18,451,371 | 5,533,564 | 17,994,581 | 5,526,088 |
| Basic and diluted net loss per share | \$ (0.15) | \$ (0.59) | \$ (0.36) | \$ (0.51) |

For all periods shown, basic and diluted net loss per share are the same. The following table includes potentially dilutive items that were not included in the computation of diluted net loss per share because to do so would be anti-dilutive:

| | Six Months Ended June 30, | |
|---|----------------------------------|-------------|
| | 2006 | 2005 |
| Unexercised stock options | 58,757 | 120,908 |
| Unexercised warrants | 48,744 | 107,878 |
| Total potentially dilutive shares of common stock equivalents | 107,501 | 228,786 |

11. LEGAL AND REGULATORY PROCEEDINGS

During June and July 2001, three separate class action lawsuits were filed against us, certain of our current and former directors and officers (the "D&Os") and firms engaged in the underwriting (the "Underwriters") of our initial public offering of stock (the "IPO"). The lawsuits, along with approximately 310 other similar lawsuits filed against other issuers arising out of initial public offering allocations, have been assigned to a Judge in the United States District Court for the Southern District of New York for pretrial coordination. The lawsuits against us have been consolidated into a single action. A consolidated amended complaint was filed on April 20, 2002. A Second Corrected Amended Complaint (the "Amended Complaint"), which is the operative complaint, was filed on July 12, 2002.

The Amended Complaint is based on the allegations that our registration statement on Form S-1, filed with the Securities and Exchange Commission ("SEC") in connection with the IPO, contained untrue statements of material fact and omitted to state facts necessary to make the statements made not misleading by failing to disclose that the underwriters allegedly had received additional, excessive and undisclosed commissions from, and allegedly had entered into unlawful tie-in and other arrangements with, certain customers to whom they allocated shares in the IPO. The plaintiffs in the Amended Complaint assert claims against us and the D&Os pursuant to Section 11 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the SEC there under. The plaintiffs in the Amended Complaint assert claims against the D&Os pursuant to Sections 11

and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the SEC there under. The plaintiffs seek an undisclosed amount of damages, as well as pre-judgment and post-judgment interest, costs and expenses, including attorneys' fees, experts' fees and other costs and disbursements. Initial discovery has begun. We believe we are entitled to indemnification from our Underwriters. A settlement has been reached by the plaintiffs, the issuers and insurers of the issuers. The principal terms of the proposed settlement are (i) a release of all claims against the issuers and their officers and directors, (ii) the assignment by the issuers to the plaintiffs of certain claims the issuers may have against the Underwriters and (iii) an undertaking by the insurers to ensure the plaintiffs receive not less than \$1 billion in connection with claims against the Underwriters. Hence, under the terms of the proposed settlement our financial obligations will likely be covered by insurance. To be binding the settlement must be approved by the court. The court has given preliminary, but not final approval of the settlement. A fairness hearing was held April 24, 2006. The court has not yet made its

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ruling as to fairness. There is no assurance that the settlement will be finally approved by the court. Susan Schad, on behalf of herself and all others similarly situated, filed a putative class action lawsuit against Trinsic Communications, Inc. (formerly known as Z-Tel Communications, Inc.), our wholly-owned subsidiary corporation, on May 13, 2004. The Original Complaint alleged that our subsidiary engaged in a pattern and practice of deceiving consumers into paying amounts in excess of their monthly rates by deceptively labeling certain line-item charges as government-mandated taxes or fees when in fact they were not. The Original Complaint sought to certify a class of plaintiffs consisting of all persons or entities who contracted with Trinsic for telecommunications services and were billed for particular taxes or regulatory fees. The Original Complaint asserted a claim under the Illinois Consumer Fraud and Deceptive Business Practices Act and sought unspecified damages, attorneys' fees and court costs. On June 22, 2004, we filed a notice of removal in the state circuit court action, removing the case to the federal district court for the Northern District of Illinois, Eastern Division, C.A. No. 4 C 4187. On July 26, 2004, Plaintiff filed a motion to remand the case to the state circuit court. On January 12, 2005, the federal court granted the motion and remanded the case to the state court. On October 17, 2005, the state court heard argument on Trinsic's motion to dismiss the lawsuit and granted that motion, in part with prejudice. The court dismissed with prejudice the claims relating to the E911 Tax, the Utility Users Tax, and the Communications Service Tax. The court found that those tax charges were specifically authorized by state law or local ordinance, and thus cannot be the basis of a Consumer Fraud claim. The court also dismissed (but with leave to replead) the claims relating to the Interstate Recovery Fee and the Federal Regulatory Compliance Fee. The court determined that plaintiff had failed to allege how she was actually damaged by the allegedly deceptive description of the charges. On November 15, 2005, Plaintiff filed a First Amended Class Action Complaint alleging that Trinsic mislabeled its Interstate Recovery Fee and Federal Cost Recovery Fee in supposed violation of the Illinois Consumer Fraud and Deceptive Business Practices Act. As with the Original Complaint, the First Amended Class Action Complaint seeks damages, fees, costs, and class certification. Trinsic filed a further Motion to Dismiss which was heard by the Court on April 3, 2006. The Court granted our motion by dismissing Plaintiff's claims for unfair practices under the Illinois Consumer Fraud and Deceptive Business Practices Act and dismissing in part Plaintiff's claims for deceptive practice under the Act. The court determined that the Plaintiff did not state sufficient facts indicating that her alleged damages were caused by our alleged deception. The Plaintiff was granted 21 days in which to replead the claims of deception. On April 24, 2006, the Plaintiff filed a Second Amended Class Action Complaint again alleging that Trinsic mislabeled its Interstate Recovery Fee and Federal Cost Recovery Fee in supposed violation of the Illinois Consumer Fraud and Deceptive Business Practices Act. The Second Amended Class Action Complaint seeks damages, fees, costs, and class certification. Trinsic has moved to dismiss this Second Amended Class Action Complaint, and hearing is set on the motion for August 28, 2006. We believe the plaintiff's allegations are without merit and intend to defend the lawsuit vigorously, but we cannot predict the outcome of this litigation with any certainty.

On November 19, 2004, the landlord of our principal Tampa, Florida facility sued us seeking a declaration of its rights and obligations under the lease and damages for breach of contract. We assert that the landlord has failed to provide certain services in accordance with the lease, including maintenance of air conditioning and emergency electrical generating systems crucial to our operations. We have taken steps necessary to provide this maintenance and have offset the costs of these measures against the rent, which we believe we are entitled to do under the lease. Thus far we have withheld approximately \$274,000. We also believe we are entitled to reimbursement from the landlord for approximately \$23,000 in costs associated with improvements to the leased space.

On November 19, 2004, a provider of parking spaces for our Tampa facilities sued us for parking fees in excess of \$334,300. Pursuant to our lease we are entitled to a number of free spaces and we are obligated to pay for additional usage of parking spaces. We believe the provider has substantially overstated our use of the spaces. We have a tentative settlement understanding with the plaintiff. Under the proposed settlement, we expect to pay a total of \$150,000, payable in installments over seven months.

12. SEGMENT REPORTING

We have two reportable operating segments: Retail Services and Wholesale Services.

The retail services segment includes our residential and business services that offer bundled local and long-distance telephone services in combination with enhanced communication features accessible, through the telephone, the

Internet and certain personal digital assistants. We offer these services in forty-nine states. This segment also includes our Touch 1 residential long-distance offering that is available nation-wide.

The wholesale services segment allows companies to offer telephone exchange and enhanced services to residential and small business customers. Sprint was our only wholesale customer during 2005 and 2006. As discussed in Note 5 above, we have acquired all of the Sprint lines for which we previously provided wholesale services.

Management evaluates the performance of each business unit based on segment results, exclusive of adjustments for unusual items and depreciation and amortization. Special items are transactions or events that are included in our reported consolidated results but are excluded from segment results due to their nonrecurring or non-operational nature. It is also important to understand when viewing our segment results that we only record direct expenses in our wholesale services and therefore, all employee benefits, occupancy, insurance, and other indirect or overhead related expenses are reflected in the retail services segment.

The following summarizes the financial information concerning our reportable segments for the three and six months ended June 30,

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2006 and 2005:

| | Three Months Ended | | Six Months Ended | |
|-------------------------------|---------------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Retail Services | | | | |
| Revenues | \$43,428 | \$40,308 | \$83,479 | \$84,333 |
| Depreciation and amortization | \$ 1,887 | \$ 2,907 | \$ 4,000 | \$ 7,050 |
| Segment results | \$ 2,577 | \$ (1,912) | \$ 2,136 | \$ (6,170) |
| Capital expenditures | \$ 670 | \$ 401 | \$ 1,053 | \$ 1,633 |
| Identifiable assets | | | \$43,621 | \$50,315 |

| | Three Months Ended | | Six Months Ended | |
|-------------------------------|---------------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Wholesale Services | | | | |
| Revenues | \$ 450 | \$10,489 | \$4,255 | \$23,595 |
| Depreciation and amortization | \$2,306 | \$ 48 | \$3,176 | \$ 84 |
| Segment results | \$ (377) | \$ 2,993 | \$ 776 | \$ 6,819 |
| Capital expenditures | \$ | \$ | \$ | \$ |
| Identifiable Assets | | | \$4,598 | \$ 5,662 |

The following table reconciles our segment information to the consolidated financial information for the three and six months ended June 30, 2006 and 2005:

| | Three Months Ended | | Six Months Ended | |
|--------------------|---------------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Revenues | | | | |
| Retail segment | \$ 43,428 | \$ 40,308 | \$ 83,479 | \$ 84,333 |
| Wholesale segment | 450 | 10,489 | 4,255 | 23,595 |
| Total consolidated | \$ 43,878 | \$ 50,797 | \$ 87,734 | \$ 107,928 |

| | Three Months Ended | | Six Months Ended | |
|-----------------------------------|---------------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Segment results: | | | | |
| Retail segment | \$ 2,577 | \$ (1,912) | \$ 2,136 | \$ (6,170) |
| Wholesale segment | (377) | 2,993 | 776 | 6,819 |
| Depreciation and amortization | (4,193) | (2,955) | (7,176) | (7,134) |
| Total consolidated operating loss | \$ (1,993) | \$ (1,874) | \$ (4,264) | \$ (6,485) |

13. SUBSEQUENT EVENTS

Effective July 27, 2006, we finalized a settlement with an ILEC over disputed balances that will reduce our net accounts payable balance by \$12.1 million. We paid a total of \$3.9 million, \$0.5 million of which had been paid as of June 30, 2006. The remainder was paid in July 2006. The settlement, which was contingent upon final payment of the full \$3.9 million, will result in a net gain of approximately \$8.2 million that will be reflected in our third quarter

statement of operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

You should read the following discussion together with financial statements and related notes included in this document. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those projected in the forward-looking statements as a result of certain factors, including, but not limited to, those discussed in Item 1. Business, as well as Cautionary Statements Regarding Forward-Looking Statements, and Item 1A. Risk Factors included in

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our Form 10-K filed with the Securities and Exchange Commission on March 31, 2006, and other factors relating to our business and us that are not historical facts. Factors that may affect our results of operations include, but are not limited to, our limited operating history and cumulative losses, access to financing, uncertainty of customer demand, rapid expansion, potential software failures and errors, potential network and interconnection failure, dependence on local exchange carriers, dependence on third party vendors, dependence on key personnel, uncertainty of government regulation, legal and regulatory uncertainties, and competition. We disclaim any obligation to update information contained in any forward-looking statement.

OVERVIEW

We offer local and long distance telephone services in combination with enhanced communication features accessible through the telephone or the Internet. These features include Personal Voice Assistant (PVA), Find-Me, Notify-Me, caller identification, call waiting and speed dialing. PVA allows users to store contacts in a virtual address book and then access and utilize that information by voice from any telephone. PVA users can also send voice e-mails. We provide advanced, integrated telecommunications services targeted to residential and business customers. We have successfully deployed Cisco soft switches in the Tampa and New York City markets, which allows us to provision VoIP services. In addition to providing our services on a retail basis, we are also providing these services on a wholesale basis. Our wholesale services provide other companies the ability to utilize our telephone exchange services, enhanced services platform, infrastructure and back-office operations to provide services to retail and business customers on a private label basis. For management purposes, we are organized into two reportable operating segments: retail services and wholesale services. As discussed in Note 5 to the consolidated financial statements, during second quarter we completed our acquisition of all of the lines for which we previously provided wholesale services. The nature of our business is rapidly evolving, and we have a limited operating history.

RESULTS OF OPERATIONS

The following discussion of results of operations is by business segment. Management evaluates the performance of each business unit based on segment results, after making adjustments for unusual items. Unusual items are transactions or events that are included in our reported consolidated results, but are excluded from segment results due to their non-recurring or non-operational nature. See our segment footnote to our consolidated financial statements for a reconciliation of segmented results to the consolidated financial information.

Revenues

| | For the three months | | Percentage of | |
|---|----------------------|---------|---------------|--------|
| | ended June 30, | | Revenues | |
| Total revenues by segment (in millions) | 2006 | 2005 | 2006 | 2005 |
| Retail Segment | \$ 43.4 | \$ 40.3 | 99.0% | 79.3% |
| Wholesale segment | 0.5 | 10.5 | 1.0% | 20.7% |
| Total Revenues | \$ 43.9 | \$ 50.8 | 100.0% | 100.0% |

| | For the six months | | Percentage of | |
|---|--------------------|----------|---------------|--------|
| | ended | | Revenues | |
| Total revenues by segment (in millions) | June 30, | | 2006 | 2005 |
| Retail Segment | \$ 83.5 | \$ 84.3 | 95.1% | 78.1% |
| Wholesale segment | 4.3 | 23.6 | 4.9% | 21.9% |
| Total Revenues | \$ 87.7 | \$ 107.9 | 100.0% | 100.0% |

Two significant drivers impact our revenues: number of lines in service and average (monthly) revenue per unit (ARPU). The more significant driver impacting our changes in revenue is the number of lines in service. The table below provides a detailed break-down of our lines:

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| Type of Service | Average lines in service for the three months ended June 30, | | Average lines in service for the six months ended June 30, | |
|------------------------------|--|---------|--|---------|
| | 2006 | 2005 | 2006 | 2005 |
| Bundled residential services | 165,920 | 164,124 | 160,079 | 177,560 |
| Bundled business services | 45,227 | 45,957 | 46,547 | 46,705 |
| 1+ long distance services | 26,695 | 34,386 | 27,688 | 36,151 |
| Wholesale services | 6,008 | 232,640 | 26,340 | 255,426 |
| VoIP | 3,341 | 4,366 | 3,350 | 3,425 |
| Total lines under management | 247,192 | 481,473 | 264,002 | 519,267 |

| Type of Service | Ending lines in service as of June 30, | |
|------------------------------|--|---------|
| | 2006 | 2005 |
| Bundled residential services | 158,821 | 144,609 |
| Bundled business services | 44,323 | 45,023 |
| 1+ long distance services | 26,131 | 35,927 |
| Wholesale services | | 212,423 |
| VoIP | 3,202 | 5,218 |
| Total lines under management | 232,477 | 443,200 |

Average and ending lines in service for 2006 include the lines purchased from Sprint. See Footnote 5 Intangible Assets.

ARPU provides us with a business measure as to the average monthly revenue generation attributable to each line in service, by business segment. ARPU is calculated by taking total revenues over a period divided by the number of months in the period to calculate the average revenue per month and this total is divided by the average lines in service during the period. We use this measure when analyzing our retail services business, but not when assessing our wholesale services business for the reasons summarized earlier within this section. The following table provides a detail of our ARPU:

| Average revenue per unit in service | For the three months ended June 30, | | For the six months ended June 30, | |
|-------------------------------------|--|---------|--------------------------------------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| Bundled residential services | \$73.33 | \$69.26 | \$72.46 | \$67.11 |
| Bundled business services | \$43.48 | \$34.82 | \$42.25 | \$35.68 |
| 1+ long distance services | \$12.49 | \$13.57 | \$12.64 | \$12.91 |

Price increases went into effect in the second quarter and the fourth quarter of 2005, causing the ARPU to increase for the three and six months ended June 30, 2006 as compared to the same periods in 2005.

The company expects both its retail and wholesale revenue to decline in 2006. The expected decrease is the result of the anticipated sale of access lines to BellSouth, termination of the company's wholesale operations, and normal attrition of the remaining customer base. The decrease should be partially offset by the acquisition of access lines from Sprint and the rate changes noted above.

Retail Segment

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| Retail segment revenues by type (in millions) | For the three months | | Percentage of Revenues | |
|---|----------------------|---------|------------------------|--------|
| | ended June 30, | | 2006 | 2005 |
| | 2006 | 2005 | 2006 | 2005 |
| Bundled residential services | \$ 36.5 | \$ 34.1 | 84.0% | 84.6% |
| Bundled business services | 5.9 | 4.8 | 13.6% | 11.9% |
| 1+ long-distance services | 1.0 | 1.4 | 2.4% | 3.5% |
| Total Revenues | \$ 43.4 | \$ 40.3 | 100.0% | 100.0% |

| Retail segment revenues by type (in millions) | For the six months ended | | Percentage of Revenues | |
|---|--------------------------|---------|------------------------|--------|
| | June 30, | | 2006 | 2005 |
| | 2006 | 2005 | 2006 | 2005 |
| Bundled residential services | \$ 69.6 | \$ 71.5 | 83.3% | 84.8% |
| Bundled business services | 11.8 | 10.0 | 14.1% | 11.9% |
| 1+ long-distance services | 2.1 | 2.8 | 2.6% | 3.3% |
| Total Revenues | \$ 83.5 | \$ 84.3 | 100.0% | 100.0% |

During the three months ended June 30, 2006, the increases in bundled residential and bundled business revenue as compared to the same period in 2005, were primarily the result of the conversion of Sprint wholesale lines to the retail segment in addition to the price increases mentioned above. The decline in 1+ long distance revenue for these same comparative periods was primarily the result of the decline in 1+ long distance lines.

During the six months ended June 30, 2006, the decreases in bundled residential and 1+ long distance revenue as compared to the six months ended June 30, 2005, were attributable to the decreases in average lines in service during the six month period in 2006 as compared to 2005. Bundled business revenue increased during this same time period due to price increases.

Wholesale Segment

| Wholesale segment revenues by type (in millions) | For the three months | | Percentage of Revenues | |
|--|----------------------|---------|------------------------|--------|
| | ended June 30, | | 2006 | 2005 |
| | 2006 | 2005 | 2006 | 2005 |
| Sprint | \$ 0.5 | \$ 10.5 | 100.0% | 100.0% |
| Total Revenues | \$ 0.5 | \$ 10.5 | 100.0% | 100.0% |

| Wholesale segment revenues by type (in millions) | For the six months ended | | Percentage of Revenues | |
|--|--------------------------|---------|------------------------|--------|
| | June 30, | | 2006 | 2005 |
| | 2006 | 2005 | 2006 | 2005 |
| Sprint | \$ 4.3 | \$ 23.6 | 100.0% | 100.0% |

| | | | | |
|----------------|--------|---------|--------|--------|
| Total Revenues | \$ 4.3 | \$ 23.6 | 100.0% | 100.0% |
|----------------|--------|---------|--------|--------|

Sprint wholesale lines have decreased from 212,423 at June 30, 2005 to zero at June 30, 2006, resulting in a significant decline in wholesale revenue. Given our decision to exit the wholesale services offering, we do not expect to have any wholesale revenue going forward.

Network Operations

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Our network operations expense primarily consists of fixed and variable transmission expenses for the leasing of the UNE-P components from ILECs, domestic and international charges from service level agreements with IXC's, and USF and certain other regulatory charges. The following table shows the detail by segment of network operations expense:

| | For the three months ended June 30, | | Percentage of Segment Revenues | |
|--|-------------------------------------|---------|--------------------------------|-------|
| Network operations expense, exclusive of depreciation and amortization expense, by segment (in millions) | 2006 | 2005 | 2006 | 2005 |
| Retail Segment | \$ 27.6 | \$ 21.4 | 63.6% | 53.3% |
| Wholesale Segment | 0.5 | 5.6 | 120.3% | 53.3% |
| Total Network Operations Expense | \$ 28.2 | \$ 27.0 | 64.2% | 53.3% |

| | For the six months ended June 30, | | Percentage of Segment Revenues | |
|--|-----------------------------------|---------|--------------------------------|-------|
| Network operations expense, exclusive of depreciation and amortization expense, by segment (in millions) | 2006 | 2005 | 2006 | 2005 |
| Retail Segment | \$ 50.5 | \$ 44.3 | 60.5% | 52.3% |
| Wholesale Segment | 2.5 | 12.5 | 59.2% | 53.3% |
| Total Network Operations Expense | \$ 53.0 | \$ 56.8 | 60.4% | 52.3% |

The following table shows the detail by type of network operations expense:

| | For the three months ended June 30, | | Percentage of Network Operations | |
|---|-------------------------------------|---------|----------------------------------|-------|
| Network operations expense, exclusive of depreciation and amortization, by type (in millions) | 2006 | 2005 | 2006 | 2005 |
| Bundled residential services | \$ 23.1 | \$ 17.8 | 82.2% | 66.0% |
| Bundled business services | 4.4 | 3.4 | 15.5% | 12.6% |
| 1+ long distance services | 0.1 | 0.2 | 0.4% | 0.7% |
| Wholesale services | 0.5 | 5.6 | 1.9% | 20.7% |
| Total | \$ 28.2 | \$ 27.0 | 100% | 100% |

| | For the six months ended June 30, | | Percentage of Network Operations | |
|---|-----------------------------------|---------|----------------------------------|-------|
| Network operations expense, exclusive of depreciation and amortization, by type (in millions) | 2006 | 2005 | 2006 | 2005 |
| Bundled residential services | \$ 42.0 | \$ 36.8 | 79.2% | 64.8% |
| Bundled business services | 8.2 | 7.0 | 15.5% | 12.3% |
| 1+ long distance services | 0.3 | 0.5 | 0.5% | 0.9% |

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| | | | | |
|--------------------|---------|---------|------|-------|
| Wholesale services | 2.5 | 12.5 | 4.8% | 22.0% |
| Total | \$ 53.0 | \$ 56.8 | 100% | 100% |

During the three and six months ended June 30, 2006, network operations expense increased as compared to the same periods in 2005 for residential and business services. This is primarily due to increases in ILEC fees. For 1+ long distance services, the increased

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ILEC fees were offset by the decrease in lines in service, causing network operations expense to decrease slightly from 2005 to 2006. Network operations expense decreased significantly for wholesale services during 2006 as compared to 2005 as a result of our acquisition of Sprint lines that we previously served on a wholesale basis. We also analyze the average expense per unit (AEPU) for network operations, similar to the ARPU calculation for revenues. AEPU is calculated by taking total network operations expense over a period divided by the number of months in the period to calculate the average expense per month and this total is divided by the average lines in service during the period. The following details AEPU for network operations expense.

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|--|---------|--------------------------------------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| Average network operations expense per unit | | | | |
| Bundled residential services | \$46.41 | \$36.15 | \$43.73 | \$34.54 |
| Bundled business services | \$32.43 | \$24.66 | \$29.36 | \$24.98 |
| 1+ long distance services | \$ 1.25 | \$ 1.94 | \$ 1.81 | \$ 2.31 |

During 2006, AEPU increased because of rate increases associated with the FCC's UNE-P ruling effective March 11, 2005 and our commercial services agreements.

We expect network operations expense to increase in 2006 as we experience rate increases associated with our commercial services agreements with ILECs as well as increases attributable to the acquisition of the local access lines from Sprint.

Retail Segment

The following table provides a detail of network operations expense as a percentage of revenues by the respective revenue types. This table excludes an analysis of the wholesale services business segment because management does not evaluate this measure, given that network expenses related to wholesale services are intended to be zero-margin direct cost pass-through in nature.

| | For the three months ended June 30, | | For the six months ended June 30, | |
|--|--|-------|---|-------|
| | 2006 | 2005 | 2006 | 2005 |
| Network operations expense as a percentage of revenues | | | | |
| Bundled residential services | 63.4% | 52.2% | 60.3% | 51.5% |
| Bundled business services | 73.7% | 70.8% | 69.9% | 70.0% |
| 1+ long distance services | 11.8% | 14.3% | 12.8% | 17.9% |

During the three and six months ended June 30, 2006 as compared to the same periods in the prior year, network operations expense as a percentage of revenues increased for bundled residential and business services. The increase is a direct result of rate increases associated with the FCC's UNE-P ruling effective March 11, 2005 and our commercial services agreements with Qwest, Verizon, SBC Communications (now AT&T) and BellSouth.

Wholesale Segment

Network operations expense from the wholesale segment decreased significantly for the three and six month periods ended June 30, 2006 as compared to the same periods in 2005. This was the result of the significant decrease in wholesale lines in service during 2006.

Sales and Marketing

The sales and marketing expense primarily consists of telemarketing, direct mail, brand awareness advertising and independent sales representative commissions and salaries and benefits paid to employees engaged in sales and marketing activities. The following table shows the detail by segment of sales and marketing expense:

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| Sales & marketing expense by segment (in millions) | For the three months ended June 30, | | Percentage of Segment Revenues | |
|--|-------------------------------------|--------|--------------------------------|------|
| | 2006 | 2005 | 2006 | 2005 |
| Retail Segment | \$ 1.1 | \$ 3.7 | 2.5% | 9.2% |
| Wholesale segment | | | 0.0% | 0.0% |
| Total Sales & Marketing Expense | \$ 1.1 | \$ 3.7 | 2.4% | 7.3% |

| Sales & marketing expense by segment (in millions) | For the six months ended June 30, | | Percentage of Segment Revenues | |
|--|-----------------------------------|--------|--------------------------------|-------|
| | 2006 | 2005 | 2006 | 2005 |
| Retail Segment | \$ 2.7 | \$ 8.9 | 3.2% | 10.6% |
| Wholesale segment | | | 0.0% | 0.0% |
| Total Sales & Marketing Expense | \$ 2.7 | \$ 8.9 | 3.0% | 8.2% |

Retail Segment

During the three and six months of 2006, sales and marketing expense decreased significantly as compared to the same periods in 2005. This was mainly due to a decrease in sales commissions and payroll related expenses.

Decreases were also experienced in direct mail expenses and marketing expenses as we have not actively marketed to VoIP or UNE-P customers in 2006.

Wholesale Segment

We are not actively seeking any new wholesale relationships at this time, therefore we have not incurred any expenses related to this segment for either period presented.

General and Administrative

General and administrative expense primarily consists of employee salaries and benefits, outsourced services, bad debt expense, billing and collection costs, occupancy costs, legal and provisioning costs. The following table shows the detail by segment of general and administrative expense:

| General & administrative expense by segment (in millions) | For the three months ended June 30, | | Percentage of Segment Revenues | |
|---|-------------------------------------|---------|--------------------------------|-------|
| | 2006 | 2005 | 2006 | 2005 |
| Retail Segment | \$ 12.2 | \$ 17.1 | 28.0% | 42.4% |
| Wholesale segment | 0.3 | 1.9 | 63.3% | 18.1% |
| Total General & Administrative Expense | \$ 12.5 | \$ 19.0 | 28.4% | 37.4% |

| General & administrative expense by segment (in millions) | For the six months ended June 30, | | Percentage of Segment Revenues | |
|---|-----------------------------------|---------|--------------------------------|-------|
| | 2006 | 2005 | 2006 | 2005 |
| Retail Segment | \$ 28.2 | \$ 37.2 | 33.8% | 44.1% |
| Wholesale segment | 1.0 | 4.3 | 22.5% | 18.2% |

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| | | | | |
|--|---------|---------|-------|-------|
| Total General & Administrative Expense | \$ 29.2 | \$ 41.5 | 33.2% | 38.5% |
|--|---------|---------|-------|-------|

The decrease in general and administrative expenses during the three and six months ended June 30, 2006 as compared to the same periods in 2005 is explained by decreases in payroll and payroll related expenses, contract development, travel expenses, billing and

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collection expenses, hardware and software support expenses, tax and licenses expenses, bad debt expenses, customer provisioning expenses and incorrect dispatch expenses.

We have improved our operating costs and overall operations. Decreases in total lines in service have directly impacted our general and administrative needs, causing a significant reduction in many of the expense items listed above. We anticipate general and administrative expenditures will decrease in total into the future as management continues to rationalize its operating cost structure. We will continue to evaluate our operations for efficiencies and our employee staffing requirements as they relate to increased efficiencies or needs to expand or outsource services.

Retail Segment

General and administrative expense decreased significantly for the three and six months ended June 30, 2006 as compared to those same periods in the prior year. The largest decreases occurred in payroll and payroll related expenses, bad debt expenses, hardware and software support expenses, tax and licenses expenses, travel expenses and incorrect dispatch expenses.

Included in the retail services general and administrative expense are all employee benefits expenses, occupancy, insurance, and other indirect or overhead-related expenses as only direct costs are recorded within our wholesale services business segment.

Wholesale Segment

The decreases in general and administrative expense for the three and six months ended June 30, 2006 as compared to the same periods in 2005 are a direct result of our acquisition of the Sprint wholesale lines. The expense line items that decreased most significantly are payroll and payroll related expenses, contract development, billing expenses and customer provisioning expenses.

Depreciation and Amortization

Depreciation and amortization expense increased for the three and six months ended June 30, 2006 as compared to the prior year periods. The increase was the result of the amortization expense related to our customer list intangible that was created upon the acquisition of the Sprint lines in 2006.

Interest and Other Income

Interest and other income primarily consists of interest charged to our bundled residential and business customers for not paying their bills on time and income from interest earned on our cash balances.

During the six months ended June 30, 2005, interest and other income also includes \$6 million of lawsuit proceeds from a legal settlement.

Interest and Other Expense

Interest and other expense includes late fees for vendor payments, discount fees related to our accounts receivable financing agreement, interest related to the asset based loan with Textron and our standby credit facility, capital leases and our other debt obligations.

The increases in interest and other expense during the three and six months ended June 30, 2006 as compared to the same periods in 2005 were primarily attributable to the discount fees we incurred on our accounts receivable financing agreement, as well as an increase in late fees for vendor payments.

LIQUIDITY AND CAPITAL RESOURCES

Our inability to operate profitably and to consistently generate cash flows from operations and our reliance therefore on external funding either from loans or equity raise substantial doubt about our ability to continue as a going concern. The accompanying consolidated financial statements were prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The realization of assets and the satisfaction of liabilities in the normal course of business is dependent upon, among other things, our ability to operate profitably, to generate cash flow from operations and to obtain funding adequate to fund its business.

Our operations are subject to certain risks and uncertainties, particularly related to the evolution of the regulatory environment, which impacts our access to and cost of the network elements that we utilize to provide services to our customers.

We have incurred significant losses since our inception as a result of developing our business, performing ongoing research and development, building and maintaining our network infrastructure and technology, the sale and promotion of our services, and

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ongoing administrative expenditures. As of June 30, 2006, we had an accumulated deficit of approximately \$430.7 million and \$0.7 million in cash and cash equivalents. We have funded our expenditures primarily through operating revenues, private securities offerings, our asset based loan, our standby credit facility, a sale-leaseback credit facility, an accounts receivable factoring facility and an initial public offering.

For the six months ended June 30, 2006, net cash provided by operating activities was \$4.8 million as compared to \$0.5 million for the same period in the prior year.

On April 4, 2005, we entered into an accounts receivable financing agreement with Thermo Credit, LLC (Thermo). The agreement provides for the sale of up to \$33 million of our accounts receivable on a continuous basis to Thermo, subject to selection criteria as defined in the contract.

On December 15, 2005, we borrowed \$1.0 million from the 1818 Fund III, L.P. (the Fund) in order to take advantage of a tax settlement with the State of New York. On January 12, 2006, we borrowed \$1.0 million from the Fund for general corporate purposes. In connection with the loan, and the previous \$1,000,000 loan received December 15, 2005, we delivered to the Fund a promissory note bearing interest at 12% annually and due on demand and a mortgage on certain real property we own in Atmore, Alabama where we have an operations center. Under the promissory note we may be required to grant additional security to the Fund.

Our net cash used in investing activities was \$2.8 million for the six months ended June 30, 2006, compared to \$1.6 million for the same period in the prior year. The increase was attributable to purchasing local access lines from Sprint in 2006.

For the six months ended June 30, 2006, net cash provided by financing activities was \$1.4 million as compared to \$0.3 million for the same period in 2005. This increase in 2006 is primarily the result of the money borrowed from the Fund, the sale of a building mentioned in Note 6 and the purchase of local access lines from Sprint.

Over the course of the first five months in 2006, we acquired 111,697 UNE-P local access lines from Sprint for which we previously provided services on a wholesale basis. We acquired the lines pursuant to a definitive agreement dated October 25, 2005. Under the agreement we purchased the lines for \$11.2 million, \$4.9 million of which has been paid as of June 30, 2006. The total purchase price includes \$1.3 million that was escrowed during the latter part of 2005. The remaining purchase price will be paid in monthly installments through July 2007. As a result of this transaction with Sprint, we will no longer have any wholesale lines subsequent to second quarter 2006.

On February 13, 2006, we entered into a definitive agreement to sell approximately 43,000 local access lines to Access Integrated Networks, Inc., a privately-held telephone company headquartered in Macon, Georgia. The lines represent substantially all of our residential and small business lines within BellSouth territories, including Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina and Tennessee. Lines serving multi-unit enterprises were excluded from the sale. The total purchase price will depend upon the number of lines in service at the time of closing. As of August 1, 2006, we had approximately 29,000 lines in service to be included in this sale. In addition, Access Integrated Networks agreed to utilize our voicemail platform for at least one year after the sale. We expect this sale to close during the third quarter.

On March 3, 2006 we initiated a reduction in force which terminated the employment of approximately 118 employees. All post termination wages and salaries were paid out as of April 7, 2006. In association with the reduction in force we have ceased actively marketing our IP telephony services. Services to our current IP telephony customers will be unaffected.

In June 2006, we sold a building to a related party for cash proceeds of \$0.4 million. The proceeds were used to payoff our note payable to Corman Elegre and to make a small principal paydown on our \$2 million loan from the Fund mentioned above. We recorded a \$0.1 million loss associated with the sale.

Effective July 27, 2006, we finalized a settlement with an ILEC over disputed balances that will reduce our net accounts payable balance by \$12.1 million. We paid a total of \$3.9 million, \$0.5 million of which had been paid as of June 30, 2006. The remainder was paid in July 2006. The settlement, which was contingent upon final payment of the full \$3.9 million, will result in a net gain of approximately \$8.2 million that will be reflected in our third quarter statement of operations.

DEBT INSTRUMENTS

Accounts Receivable Financing

On April 4, 2005, we entered into an accounts receivable financing agreement with Thermo Credit, LLC (Thermo). The agreement provides for the sale of up to \$22 million of our accounts receivable on a continuous basis to Thermo, subject to selection criteria as defined in the contract.

During October 2005, we signed an amendment to our accounts receivable financing agreement with Thermo. The amendment increases the amount of accounts receivable that we can sell to Thermo from \$22 million to \$26 million, subject to selection criteria as

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defined in the original contract. The discount rate also increases from 2.5% to 2.75%. On February 1, 2006, we amended our accounts receivable financing facility once more by increasing the facility to \$33 million.

ILEC, IXC AND RELATED DISPUTED CHARGES

Since our existence we have disputed and continue to dispute significant charges from the various ILECs, IXCs, and certain other carriers providing us services. We have a policy of treating all charges that we believe are without merit, but are still being presented on a bill to us as disputes, regardless of the age of the dispute. Our outstanding disputes at June 30, 2006 are summarized in the following table:

| | Outstanding Disputes at June 30, 2006 (in millions) |
|---|--|
| Alternatively billed services | \$ 6.0 |
| Late fees for non-payment of disputed charges | 7.3 |
| Billing errors | 5.2 |
| All others | 2.0 |
| | \$ 20.5 |

Alternatively billed services are primarily charges for certain 1-800, collect and information service calls. These disputes are largely historic in nature. We remit all monies collected associated with these services but do not pay the charges unless we collect from our customers. We believe that our liability related to these charges should be capped at the amount remitted by our end users; however, some of our settlements have included payments in excess of payments from our customers.

The late fees are accumulating from all of our disputes as we do not pay for disputed items and therefore incur and accumulate late fees for these disputed billings.

We believe that we have adequately accrued for our disputes and we believe our maximum exposure for these charges is \$20.5 million. However, we do not believe that all of these charges are valid and intend to continue our dispute and non-payment of these charges.

Effective July 27, 2006, we finalized a settlement with an ILEC over disputed balances that will reduce our net accounts payable balance by \$12.1 million. We paid a total of \$3.9 million, \$0.5 million of which had been paid as of June 30, 2006. The settlement, which was contingent upon final payment of the full \$3.9 million, will result in a net gain of approximately \$8.2 million that will be reflected in our third quarter statement of operations. The outstanding dispute balance of \$20.5 million shown above will be reduced by \$17.2 million in the third quarter as a result of this settlement.

RELATED PARTY TRANSACTIONS

We recorded interest on our related party debt of \$0.1 million and \$0.8 million during the three months ended June 30, 2006 and 2005, respectively, and we recorded interest of \$0.1 million and \$1.2 million during the six months ended June 30, 2006 and 2005, respectively.

In June 2006, we sold a building to a related party for cash proceeds of \$0.4 million. The proceeds were used to payoff our note payable to Corman Elegre and to make a small principal paydown on our \$2 million loan from the Fund mentioned above. We recorded a \$0.1 million loss associated with the sale.

SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

See Footnote 3 Significant Accounting Policies and Recent Accounting Pronouncements and Footnote 7 Stock-Based Compensation.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not enter into financial instruments for trading or speculative purposes and do not currently utilize derivative financial instruments. Our operations are conducted primarily in the United States and as such are not subject to material foreign currency exchange rate risk.

The fair value of our investment portfolio or related income would not be significantly impacted by either a 100 basis point increase or

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decrease in interest rates due mainly to the short-term nature of the major portion of our investment portfolio. We have no material future earnings or cash flow exposures from changes in interest rates on our long-term debt obligations, as substantially all of our long-term debt obligations are fixed rate obligations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to ensure that material information related to us, including our consolidated subsidiaries, is recorded, processed, summarized and reported in accordance with SEC rules and forms. Our management, with the participation of Chief Executive Officer, Horace J. Davis, III and Chief Financial Officer, Edward D. Moise, Jr., has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on their evaluation as of the end of the period covered by this report, Mr. Davis and Mr. Moise, Jr. have concluded that, as a result of the material weakness discussed below, 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) were not sufficiently effective to ensure that the information required to be disclosed by us in our SEC reports was recorded, processed, summarized and reported so as to ensure the quality and timeliness of our public disclosures in compliance with SEC rules and forms. The areas of the internal controls that are deemed by our management to contain material weaknesses surround the failure during the six months ended June 30, 2006 to retain financial reporting personnel necessary to properly identify, research, review and conclude in a timely fashion, related to certain non-routine or complex accounting issues and related disclosures timely, and the failure during the six months ended June 30, 2006 to appropriately and accurately document the Company's processes and procedures over the revenue and accounts receivable cycles, which could affect the reported results for the accounting period. The certifications attached as Exhibits 31.1 and 31.2 hereto should be read in conjunction with the disclosures set forth herein.

Changes in Internal Control over Financial Reporting

As disclosed in the Company's 2005 Annual Report on Form 10-K, the Company reported material weaknesses in the Company's internal controls surrounding the failure during the year ended December 31, 2005 to retain financial reporting personnel necessary to properly identify, research, review and conclude in a timely fashion, related to certain non-routine or complex accounting issues and related disclosures timely, and the failure during the year ended December 31, 2005 to appropriately and accurately document the Company's processes and procedures over the revenue and accounts receivable cycles, which could affect the reported results for the accounting period.

There was no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Remediation of Material Weaknesses

The material weaknesses in our disclosure controls and procedures stated above in "Evaluation of Disclosure Controls and Procedures" require us to make changes in internal controls over financial reporting. As a result, we recently hired additional financial reporting personnel with the requisite skills necessary to properly identify, research, review and conclude related to non-routine or complex accounting issues and related disclosures timely. We will also appropriately and accurately document our processes and procedures related to the revenue and accounts receivable cycles. Our management believes that these changes in review procedures and the addition of financial reporting personnel will ensure that the disclosed material weaknesses in reporting procedures no longer should have a material effect on financial reporting.

Part II

ITEM 1. LEGAL PROCEEDINGS

1. Master File Number 21 MC 92; In re Initial Public Offering Securities Litigation., in the United States District Court for the Southern District of New York (filed June 7, 2001)

During June and July 2001, three separate class action lawsuits were filed against us, certain of our current and former directors and officers (the "D&Os") and firms engaged in the underwriting (the "Underwriters") of our initial public offering of stock (the "IPO"). The lawsuits, along with approximately 310 other similar lawsuits filed against other issuers arising out of initial public offering allocations, have been assigned to a Judge in the United States District Court for the Southern District of New York for pretrial coordination. The lawsuits against us have been consolidated

into a single action. A consolidated amended complaint was filed on April 20, 2002. A Second Corrected Amended Complaint (the Amended Complaint), which is the operative complaint, was filed on July 12, 2002. The Amended Complaint is based on the allegations that our registration statement on Form S-1, filed with the Securities and Exchange Commission (SEC) in connection with the IPO, contained untrue statements of material fact and omitted to state facts necessary to make the statements made not misleading by failing to disclose that the underwriters allegedly had received additional, excessive and undisclosed commissions from, and allegedly had entered into unlawful tie-in and other arrangements with, certain

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customers to whom they allocated shares in the IPO. The plaintiffs in the Amended Complaint assert claims against us and the D&Os pursuant to Section 11 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the SEC there under. The plaintiffs in the Amended Complaint assert claims against the D&Os pursuant to Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the SEC there under. The plaintiffs seek an undisclosed amount of damages, as well as pre-judgment and post-judgment interest, costs and expenses, including attorneys' fees, experts' fees and other costs and disbursements. Initial discovery has begun. We believe we are entitled to indemnification from our Underwriters.

A settlement has been reached by the plaintiffs, the issuers and insurers of the issuers. The principal terms of the proposed settlement are (i) a release of all claims against the issuers and their officers and directors, (ii) the assignment by the issuers to the plaintiffs of certain claims the issuers may have against the Underwriters and (iii) an undertaking by the insurers to ensure the plaintiffs receive not less than \$1 billion in connection with claims against the Underwriters. Hence, under the terms of the proposed settlement our financial obligations will likely be covered by insurance. To be binding the settlement must be approved by the court. The court has given preliminary, but not final approval of the settlement. A fairness hearing was held April 24, 2006. The court has not yet made its ruling as to fairness. There is no assurance that the settlement will be finally approved by the court.

2. *C.A. No. 04CH07882, Susan Schad, on behalf of herself and all others similarly situated, v. Z-Tel Communications, Inc., In the Circuit Court of Cook County, Illinois, Illinois County Department, Chancery Division, filed May 13, 2004;*

Susan Schad, on behalf of herself and all others similarly situated, filed a putative class action lawsuit against Trinsic Communications, Inc. (formerly known as Z-Tel Communications, Inc.), our wholly-owned subsidiary corporation, on May 13, 2004. The Original Complaint alleged that our subsidiary engaged in a pattern and practice of deceiving consumers into paying amounts in excess of their monthly rates by deceptively labeling certain line-item charges as government-mandated taxes or fees when in fact they were not. The Original Complaint sought to certify a class of plaintiffs consisting of all persons or entities who contracted with Trinsic for telecommunications services and were billed for particular taxes or regulatory fees. The Original Complaint asserted a claim under the Illinois Consumer Fraud and Deceptive Business Practices Act and sought unspecified damages, attorneys' fees and court costs. On June 22, 2004, we filed a notice of removal in the state circuit court action, removing the case to the federal district court for the Northern District of Illinois, Eastern Division, C.A. No. 4 C 4187. On July 26, 2004, Plaintiff filed a motion to remand the case to the state circuit court. On January 12, 2005, the federal court granted the motion and remanded the case to the state court. On October 17, 2005, the state court heard argument on Trinsic's motion to dismiss the lawsuit and granted that motion, in part with prejudice. The court dismissed with prejudice the claims relating to the E911 Tax, the Utility Users Tax, and the Communications Service Tax. The court found that those tax charges were specifically authorized by state law or local ordinance, and thus cannot be the basis of a Consumer Fraud claim. The court also dismissed (but with leave to replead) the claims relating to the Interstate Recovery Fee and the Federal Regulatory Compliance Fee. The court determined that plaintiff had failed to allege how she was actually damaged by the allegedly deceptive description of the charges. On November 15, 2005, Plaintiff filed a First Amended Class Action Complaint alleging that Trinsic mislabeled its Interstate Recovery Fee and Federal Cost Recovery Fee in supposed violation of the Illinois Consumer Fraud and Deceptive Business Practices Act. As with the Original Complaint, the First Amended Class Action Complaint seeks damages, fees, costs, and class certification. Trinsic filed a further Motion to Dismiss which was heard by the Court on April 3, 2006. The Court granted our motion by dismissing Plaintiff's claims for unfair practices under the Illinois Consumer Fraud and Deceptive Business Practices Act and dismissing in part Plaintiff's claims for deceptive practice under the Act. The court determined that the Plaintiff did not state sufficient facts indicating that her alleged damages were caused by our alleged deception. The Plaintiff was granted 21 days in which to replead the claims of deception. On April 24, 2006, the Plaintiff filed a Second Amended Class Action Complaint again alleging that Trinsic mislabeled its Interstate Recovery Fee and Federal Cost Recovery Fee in supposed violation of the Illinois Consumer Fraud and Deceptive Business Practices Act. The Second Amended Class Action Complaint seeks damages, fees, costs, and class certification. Trinsic has moved to dismiss this Second Amended Class Action Complaint, and hearing is set on the motion for August 28,

2006. We believe the plaintiff's allegations are without merit and intend to defend the lawsuit vigorously, but we cannot predict the outcome of this litigation with any certainty.

3. *Case No. 0410453, Wilder Corporation of Delaware, Inc. v. Trinsic Communications, Inc., In the Circuit Court of the Thirteenth Judicial Circuit in and for Hillsborough County, Florida, Civil Division, Division G, filed November 19, 2004*

On November 19, 2004, the landlord of our principal Tampa, Florida facility sued us seeking a declaration of its rights and obligations under the lease and damages for breach of contract. We assert that the landlord has failed to provide certain services in accordance with the lease, including maintenance of air conditioning and emergency electrical generating systems crucial to our operations. We have taken steps necessary to provide this maintenance and have offset the costs of these measures against the rent, which we believe we are entitled to do under the lease. Thus far we have withheld approximately \$274,000. We also believe we are entitled to reimbursement from the landlord for approximately \$23,000 in costs associated with improvements to the leased space.

4. *Case No. 0410441, Beneficial Management Corporation of America v. Trinsic Communications, Inc., In the Circuit Court of the Thirteenth Judicial Circuit in and for Hillsborough County, Florida, Civil Division, Division F, filed November 19, 2004*

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On November 19, 2004, a provider of parking spaces for our Tampa facilities sued us for parking fees in excess of \$334,300. Pursuant to our lease we are entitled to a number of free spaces and we are obligated to pay for additional usage of parking spaces. We believe the provider has substantially overstated our use of the spaces. We have a tentative settlement understanding with the plaintiff. Under the proposed settlement, we expect to pay a total of \$150,000, payable in installments over seven months.

ITEM 6. EXHIBITS

**EXHIBIT
NUMBER**

DESCRIPTION

- | | |
|------|---|
| 3.1 | Amended and Restated Certificate of Incorporation of Trinsic, Inc. as amended. Incorporated by reference to the correspondingly numbered exhibit to our Annual Report on Form 10-K for the year ended December 31, 2004 filed April 15, 2005. |
| 3.2 | Amended and Restated Bylaws of Trinsic, as amended. Incorporated by reference to the correspondingly numbered exhibit to our Quarterly report on Form 10-Q for the quarter ended September 30, 2004 filed November 15, 2004. |
| 3.3 | Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Trinsic, Inc. Incorporated by reference to Exhibit 3.3 to our Form 8-K filed September 28, 2005. |
| 4.1 | Form of Common Stock Certificate. Incorporated by reference to the correspondingly numbered exhibit to our Annual Report on Form 10-K for the year ended December 31, 2004 filed April 15, 2005. |
| 4.2 | See Exhibits 3.1, 3.2 and 3.3. of this report for provisions of the Amended and Restated Certificate of Incorporation, as amended, and our Bylaws, as amended, defining rights of security holders. |
| 4.9 | Registration Rights Agreement between and among us and The 1818 Fund III, L.P. Incorporated by reference to the correspondingly numbered exhibit to our Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, filed on November 14, 2000. |
| 4.11 | Certificate of Designation of Series F Junior Participating Preferred Stock. Incorporated by reference to the correspondingly numbered exhibit to our Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 30, 2001. |
| 4.12 | Rights Agreement dated as of February 19, 2001 between Z-Tel Technologies, Inc. and American Stock Transfer & Trust Company, as Rights Agent, as amended July 2, 2001. Incorporated by reference to the correspondingly numbered exhibit to our quarterly report on Form 10-Q for the quarter ended June 30, 2001 |
| 4.13 | Amendment No. 1 to Rights Agreement dated as of November 19, 2004 between Z-Tel Technologies, Inc. and American Stock Transfer & Trust Company, as Rights Agent. Incorporated by reference to Exhibit 4.1 to our registration statement on form 8-A/A filed on December 6, 2004. |
| 4.14 | Amendment No. 2 to Rights Agreement dated as of July 19, 2005, between Trinsic, Inc. and American Stock Transfer & Trust Company, as Rights Agent. Incorporated by reference to Exhibit 4.1 to our registration statement on form 8-A/A filed on July 21, 2005. |
| 4.15 | Stock and Warrant Purchase Agreement, dated as of July 2, 2001, by and between us, D. Gregory Smith, and others. Incorporated by reference to Exhibit 1 to Amendment No. 1 of the Schedule 13D |

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filed July 12, 2001 with respect to our common stock by, among other persons, The 1818 Fund III, L.P.

- 4.20 Exchange and Purchase Agreement dated July 15, 2005 between Trinsic, Inc. and The 1818 Fund III, L.P. Incorporated by reference to Exhibit A to our Form 8-K filed July 20, 2005.
- 10.1 Employment Agreement of Horace J. Trey Davis III, dated August 15, 2005, as amended January 30, 2006. Incorporated by reference to Exhibits A and B of our Form 8-K filed April 20, 2006.
- 10.2.1 1998 Equity Participation Plan. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-89063), originally filed October 14, 1999, as amended and as effective December 14, 1999.

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EXHIBIT

NUMBER DESCRIPTION

- 10.2.2 2000 Equity Participation Plan, as amended. Incorporated by reference to the correspondingly numbered exhibit to our Annual Report on Form 10-K for the year ended December 31, 2004 filed April 15, 2005.
- 10.2.3 2004 Stock Incentive Plan. Incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-8 filed May 8, 2005.
- 10.3 Employment Agreement of Ronald R. Bailey dated August 15, 2005, as amended January 30, 2006. Incorporated by reference to Exhibits C and D of our Form 8-K filed April 20, 2006.
- 10.4 Employment Agreement of Michael M. Slauson dated August 15, 2005. Incorporated by reference to Exhibit E of our Form 8-K filed April 20, 2006
- 10.5 Form of Indemnification Agreement for our executive officers and directors. Incorporated by reference to the correspondingly numbered exhibit to our Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 30, 2001.
- 10.6 Employment Agreement of Paul T. Kohler dated August 15, 2005. Incorporated by reference to Exhibit F of our Form 8-K filed April 20, 2006.
- 10.7 Employment Agreement of John K. Lines dated August 15, 2005. Incorporated by reference to Exhibit G of our Form 8-K filed April 20, 2006.
- 10.11 Promissory Note, dated September 10, 1999, from Touch 1 Communications, Inc. to William F. Corman (First Revocable Trust). Incorporated by reference to the correspondingly numbered exhibits to our Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 30, 2001.
- 10.14 Receivables Sales Agreement, dated as of March 28, 2005, by and between Trinsic Communications Inc. and Touch 1 Communications s Inc., collectively as Seller and Subservicer, and Thermo Credit, LLC, as Purchaser and Master Servicer. Incorporated by reference to Exhibit 10.1 to our o Form 8-K filed April 5, 2005.
- 10.15 Promissory Note, dated December 15, 2005, from Trinsic, Inc. to The 1818 Fund III, L.P. Incorporated by reference to Exhibit A to Form 8-K filed December 21, 2005.
- 10.16 Agreement for Purchase and Sale of Customer Access Lines, dated October 25, 2005, by and among Sprint Communications Company L.P., Sprint Communications Company of Virginia, Inc. and Trinsic, Inc. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 31, 2006.
- 10.17 Agreement for Purchase and Sale of Customer Access Lines, dated as of February 10, 2006, between Trinsic Communications, Inc. and Access Integrated Networks, Inc. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed May 15, 2006.
- 31.1 Certification of the Chief Executive Officer
- 31.2 Certification of the Chief Financial Officer

32.1 Written Statement of the Chief Executive Officer Pursuant to 18 U.S.C.ss.1350

32.2 Written Statement of the Chief Financial Officer Pursuant to 18 U.S.C.ss.1350

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, as of the 8th day of August 2006.

TRINSIC, INC.

By: */s/ HORACE J. DAVIS, III*

Horace J. Davis, III
Chief Executive Officer

By: */s/ EDWARD D. MOISE,
JR*

Edward D. Moise, Jr.
Chief Financial Officer

A signed original of this report has been provided to Trinsic, Inc. and will be retained by the Trinsic, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.