

UCN INC  
Form 424B3  
August 14, 2006  
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Rule 424(b)(3)

SEC file No. 333-130748

**Prospectus Supplement No. 2 dated August 11, 2006**

**To Prospectus dated April 10, 2006**

**UCN, INC.**

**COMMON STOCK**

The prospectus covers 2,882,000 shares of the common stock of UCN, Inc., that may be sold from time to time by the persons listed under the caption Selling Security Holders, beginning on page 3 of the prospectus. The shares were registered under a registration statement on Form S-1 filed with the Securities and Exchange Commission in December 2005.

The 2,882,000 shares consist of 2,332,000 shares issued in private placements that closed in November and December 2005, and 550,000 shares issuable at a price of \$2.00 per share upon exercise of warrants issued in the same private placements. None of the warrants have been exercised. UCN will receive the proceeds from exercise of the warrants, if any are exercised. UCN will not receive any proceeds or benefit from resale of the shares by the selling security holders. Of the 2,882,000 shares registered, to our knowledge 132,000 have been sold by the selling security holders.

Quotations for our common stock are reported on the OTC Bulletin Board under the symbol UCNN. On August 10, 2006, the closing bid price for our common stock was \$2.70 per share.

A copy of our quarterly report on Form 10-Q (without exhibits) for the interim period ended June 30, 2006, filed with the Securities and Exchange Commission on August 11, 2006 is included in this supplement. A copy of our quarterly report on Form 10-Q (without exhibits) for the interim period ended March 31, 2006, is included in Supplement No. 1 dated May 15, 2006. Our prospectus dated April 10, 2006, incorporates by reference information presented in our annual report on Form 10-K for the year ended December 31, 2005, filed with the Securities and Exchange Commission on March 29, 2006, and our current report on Form 8-K dated March 20, 2006, filed on March 20, 2006. Please see Where You Can Find Information About UCN beginning on page 3 of the prospectus.

**See Item 1A. Risk Factors beginning on page 12 of our annual report on Form 10-K for the year ended December 31, 2005, for information you should consider before you purchase shares. Also see Item 1A. Risk Factors under Part II of our quarterly report on Form 10-Q for the interim period ended June 30, 2006, beginning on page 26 for information you should consider before you purchase shares.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.**

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**Notice About Information Presented In This Supplement**

This supplement may be used by the Selling Security Holders to offer their shares only if accompanied by the prospectus dated April 10, 2006, and Supplement No. 1 to the prospectus dated May 15, 2006.

This supplement provides information that supersedes, or is in addition to, information presented in the prospectus. If there is any difference between the information presented in this supplement and the information contained in the prospectus, you should rely on the information in this supplement.

You should rely only on the information provided in this supplement, the prospectus, and Supplement No. 1. We have not authorized anyone to provide you with different information.

We do not claim the information contained in this supplement or the accompanying prospectus is accurate as of any date other than the dates on their respective covers.

**Forward-looking Statements**

You should carefully consider the risk factors set forth in the prospectus, as well as the other information contained in this supplement and the prospectus. This supplement and the prospectus contain forward-looking statements regarding events, conditions, and financial trends that may affect our plan of operation, business strategy, operating results, and financial position. You are cautioned that any forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties. Actual results may differ materially from those included within the forward-looking statements as a result of various factors. Cautionary statements in the Risk Factors and Management's Discussion and Analysis of Operating Results and Financial Condition sections of our quarterly report on Form 10-Q, annual report on Form 10-K, and the prospectus identify important risks and uncertainties affecting our future, which could cause actual results to differ materially from the forward-looking statements made in this supplement and the prospectus.

**Selling Security Holders**

We are advised that the stock position of one of the selling security holders has changed through the purchase of additional shares. Select Contrarian Value Partners, LP, is the beneficial owner of 1,951,200 shares of common stock, of which 1,110,000 have been registered for sale and are offered under the prospectus. Kaizen Fundamental Value Fund is the beneficial owner of 110,000 shares of UCN common stock and is managed by the same person that manages Select Contrarian Value Partners, so these shares may be deemed to be held by an affiliate of Select Contrarian Value Partners. Assuming all of the shares offered under the prospectus are sold, Select Contrarian Value Partners and its affiliate would hold 3.75 percent of the issued and outstanding shares of common stock based on 25,141,984 shares of common stock outstanding at August 10, 2006.

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 20549**

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**FORM 10-Q**

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x **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 No. 0-26917

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**UCN, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of

incorporation or organization)

**14870 Pony Express Road, Bluffdale, Utah 84065**

(Address of principal executive offices and Zip Code)

**(801) 320-3300**

(Registrant's telephone number, including area code)

**87-0528557**  
(IRS Employer

Identification No.)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 25,141,984 shares of common stock as of August 10, 2006.

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**Table of Contents****UCN, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS - (Unaudited)***(in thousands except share data)*

	June 30,	December 31,
	2006	2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 4,393	\$ 5,471
Restricted cash	10	651
Accounts and other receivables, net of allowance for uncollectible accounts of \$1,556 and \$1,596, respectively	10,424	11,368
Other current assets	389	561
<b>Total current assets</b>	<b>15,216</b>	<b>18,051</b>
Property and equipment, net	5,126	5,225
Intangible assets, net	8,911	11,545
Other assets	683	822
<b>Total assets</b>	<b>\$ 29,936</b>	<b>\$ 35,643</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Line of credit	\$	\$ 3,328
Current portion of long-term debt	710	2,966
Trade accounts payable	8,789	11,380
Accrued liabilities	2,104	2,268
Accrued commissions	1,266	1,355
<b>Total current liabilities</b>	<b>12,869</b>	<b>21,297</b>
Long-term debt	7,449	5,511
Other long-term liabilities	122	247
<b>Total liabilities</b>	<b>20,440</b>	<b>27,055</b>
Commitments and contingencies (Notes 4, 8, 11, 13 and 15)		
Stockholders' equity:		
Preferred stock, \$0.0001 par value, 15,000,000 shares authorized; Series A 8% cumulative convertible preferred stock; 0 shares issued and outstanding for 2006 and 2005 (liquidation value of \$0)		
Series B 8% cumulative convertible preferred stock; 0 shares issued and outstanding for 2006 and 2005 (liquidation value of \$0)		
Common stock, \$0.0001 par value; 100,000,000 shares authorized; 25,141,984 and 23,114,669 shares issued and outstanding for June 30, 2006 and December 31, 2005, respectively	3	2
Additional paid-in capital	49,218	44,570
Warrants and options outstanding	1,277	735
Accumulated deficit	(41,002)	(36,719)
<b>Total stockholders' equity</b>	<b>9,496</b>	<b>8,588</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 29,936</b>	<b>\$ 35,643</b>

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See notes to condensed consolidated financial statements

**Table of Contents****UCN, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - (Unaudited)***(in thousands except per share data)*

	<b>Three months ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Revenue	\$ 20,968	\$ 21,488
Operating expenses:		
Costs of revenue	13,580	14,130
General and administrative	3,223	2,638
Selling and promotion	3,432	4,287
Depreciation and amortization	1,865	1,706
Research and development	352	322
Total operating expenses	22,452	23,083
Loss from operations	(1,484)	(1,595)
Other income (expense):		
Interest income	42	24
Interest expense	(326)	(226)
Loss on early extinguishment of debt	(364)	
Total other expense	(648)	(202)
Net loss before income taxes	(2,132)	(1,797)
Income tax expense	8	
Net loss	(2,140)	(1,797)
Preferred dividends		
Net loss applicable to common stockholders	\$ (2,140)	\$ (1,797)
Net loss per common share:		
Basic and diluted	\$ (0.09)	\$ (0.09)
Weighted average common shares outstanding:		
Basic and diluted	24,053	20,783

See notes to condensed consolidated financial statements



**Table of Contents****UCN, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - (Unaudited)***(in thousands except per share data)*

	<b>Six months ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Revenue	\$ 43,590	\$ 37,462
Operating expenses:		
Costs of revenue	29,063	24,501
General and administrative	6,478	4,411
Selling and promotion	7,050	8,122
Depreciation and amortization	3,744	3,210
Research and development	664	628
Total operating expenses	46,999	40,872
Loss from operations	(3,409)	(3,410)
Other income (expense):		
Interest income	82	44
Interest expense	(584)	(410)
Loss on early extinguishment of debt	(364)	
Total other expense	(866)	(366)
Net loss before income taxes	(4,275)	(3,776)
Income tax expense	8	
Net loss	(4,283)	(3,776)
Preferred dividends		(38)
Net loss applicable to common stockholders	\$ (4,283)	\$ (3,814)
Net loss per common share:		
Basic and diluted	\$ (0.18)	\$ (0.19)
Weighted average common shares outstanding:		
Basic and diluted	23,588	20,146

See notes to condensed consolidated financial statements

**Table of Contents****UCN, INC.****CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY - (Unaudited)***(in thousands)*

	Common Stock		Additional	Warrants/ Options	Accumulated	Total
	Shares	Amount	Paid-in Capital	Outstanding	Deficit	
Balance at January 1, 2006	23,115	\$ 2	\$ 44,570	\$ 735	\$ (36,719)	\$ 8,588
Exercise of employee options to purchase common shares	71		141			141
Stock-based compensation			297			297
Proceeds from private offering, net of issuance costs of \$290	1,956	1	4,210			4,211
Warrant issued in conjunction with debt financing				542		542
Net loss					(4,283)	(4,283)
Balance at June 30, 2006	25,142	\$ 3	\$ 49,218	\$ 1,277	\$ (41,002)	\$ 9,496

See notes to condensed consolidated financial statements

**Table of Contents****UCN, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)***(in thousands)*

	<b>Six months ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (4,283)	\$ (3,776)
<b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b>		
Depreciation and amortization	3,744	3,210
Amortization of debt financing costs	83	44
Stock-based compensation	297	
Loss on early extinguishment of debt	364	
<b>Changes in operating assets and liabilities:</b>		
Accounts and other receivables, net	944	(407)
Other current assets	69	52
Other non-current assets	33	(3)
Trade accounts payable	(2,774)	3,784
Accrued liabilities	(289)	(1,574)
Accrued commissions	(89)	203
<b>Net cash provided by (used in) operating activities</b>	<b>(1,901)</b>	<b>1,533</b>
<b>Cash flows from investing activities:</b>		
Decrease (increase) in restricted cash	641	(674)
Purchases of property and equipment	(632)	(659)
Acquisition of MyACD, Inc. stock		(427)
<b>Net cash provided by (used in) investing activities</b>	<b>9</b>	<b>(1,760)</b>
<b>Cash flows from financing activities:</b>		
Private placement of common stock, net of offering costs of \$290	4,211	
Net borrowings (payments) under line of credit and revolving credit facility	664	(629)
Proceeds from exercise of options and warrants	141	160
Principal payments on long-term debt and capital leases	(3,639)	(544)
Payments on early extinguishment of debt	(377)	
Debt financing fees	(186)	
<b>Net cash provided by (used in) financing activities</b>	<b>814</b>	<b>(1,013)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(1,078)</b>	<b>(1,240)</b>
Cash and cash equivalents at the beginning of the period	5,471	4,010
<b>Cash and cash equivalents at the end of the period</b>	<b>\$ 4,393</b>	<b>\$ 2,770</b>

(continued)

(continued)

See notes to condensed consolidated financial statements

**Table of Contents****UCN, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)***(in thousands)*

	<b>Six months ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Supplemental cash flow information:</b>		
Cash paid for interest	\$ 423	\$ 443
Cash paid for taxes	\$ 2	\$
<b>Supplemental schedule of non-cash investing and financing activities:</b>		
Issuance of warrants with debt agreement	\$ 542	\$
Property and equipment financed with capital lease obligations	196	818
Property and equipment included in accounts payable	183	43
Issuance of common shares in payment of preferred stock dividend		348
	(concluded)	(concluded)
See notes to condensed consolidated financial statements		

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**UCN, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 BASIS OF PRESENTATION**

These unaudited interim financial statements of UCN, Inc. and its subsidiaries (collectively, UCN) have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission (SEC). Such rules and regulations allow the omission of certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States, so long as the statements are not misleading. In the opinion of management, these financial statements and accompanying notes contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position and results of operations for the periods shown. These interim financial statements should be read in conjunction with the audited financial statements and notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the SEC on March 29, 2006. The results of operations for the three and six month period ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year.

As of June 30, 2006, UCN had a working capital surplus of \$2.3 million. UCN experienced net losses during the six months ended June 30, 2006 and 2005 of approximately \$4.3 million and \$3.8 million, respectively. Additionally, UCN experienced negative cash flow from operations for the six months ended June 30, 2005 of \$1.9 million. The primary factors affecting the cash flow used in operating activities during the second quarter were: 1) continued investments in the promotion and development of inContact to bring these services to market, 2) \$2.8 million decrease in accounts payable, 3) \$364,000 loss on early extinguishment of debt, 4) \$330,000 billing dispute in the first quarter of 2006, and 5) \$297,000 of stock-based compensation recorded year-to-date as required by SFAS 123(R).

The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should UCN be unable to continue as a going concern. UCN's continuation as a going concern is dependent upon the ability to generate sufficient cash flow to meet obligations on a timely basis and ultimately to achieve successful operations.

UCN has taken the following actions to improve its financial situation:

UCN is concentrating marketing efforts on promoting the sale of inContact technology services to existing and new customers. This focus is driven by higher gross margins for customers utilizing inContact services integrated with UCN long distance services. Revenue from the inContact segment, which includes long distance services to customers who utilize inContact technology, increased to \$3.6 million for the three months ended June 30, 2006 as compared to \$2.96 million for the first three months of 2006. Revenue from the inContact segment, which includes long distance services to customers who utilize inContact technology, through June 30, 2006 rose 269% to \$6.6 million from \$1.8 million during the same period in 2005. This was the sixth consecutive quarter of double digit growth of inContact segment revenue. Additional information regarding segments can be found in Note 14.

In May 2006, UCN closed an agreement with ComVest Capital to refinance the majority of existing short and long-term debt (Note 8). The financing arrangement provides UCN with increased liquidity and access to cash collections. As a result of the agreement, the current ratio increased to 1.18 at June 30, 2006 from 0.85 at December 31, 2005. The two primary reasons for the increase are: 1) the revolving credit facility is classified as long-term, and 2) the new convertible term note does not require debt payments for the first twelve months. The financing also released the restrictions on certain cash balances imposed by the previous line of credit. There was \$3.2 million of unused commitments at June 30, 2006 under the revolving credit note.

During May 2006, UCN raised \$4.5 million by issuing 1.96 million shares of common stock in a private placement with two institutional and accredited investors. As a result of these private placements, UCN was required to repay approximately \$1.1 million of the outstanding convertible note balance.

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UCN continued to improve cost of revenue margin by implementing cost cutting measures and increasing higher margin inContact revenue. UCN's cost of revenue margin improved by one full percentage point to 64.8% during

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the second quarter 2006 as compared to 65.8% during the second quarter 2005. UCN's cost of revenue margin has improved by 3.7 percentage points from the first quarter 2006 of 68.5% and 4.5 percentage points from the fourth quarter 2005 of 69.3%.

Through June 30, 2006, UCN generated approximately \$725,000 of additional revenue by charging certain wholesale carrier cost recovery fees to customers.

Through June 30, 2006, UCN saved approximately \$996,000 by using a lower cost long distance carrier. UCN anticipates saving a total of \$2.0 million during 2006 by continuing to use this new carrier and from the shut down of parts of the Transtel network.

UCN experienced a year-to-date net loss of \$4.3 million through June 2006. Included in net loss is depreciation and amortization of \$3.7 million, net interest expense of \$502,000 and stock-based compensation of \$297,000. Additionally, included in the net loss are unusual items including a loss on extinguishment of debt of \$364,000 incurred during the quarter and a large unusual billing dispute in the first quarter of \$330,000.

Management believes these actions will allow UCN: 1) to significantly increase cash flow available from outside sources and from operations in order to meet short-term requirements, 2) to eventually return UCN to overall profitability and 3) to enable UCN to continue as a going concern.

### NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Capitalized Software Costs: In accordance with Statement of Position 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use*, UCN capitalizes certain costs incurred for the development of internal use software. These costs include the costs associated with coding, software configuration, upgrades, and enhancements. During the three months ended June 30, 2006 and 2005, UCN capitalized approximately \$96,000 and \$97,000, respectively.

Long-Lived Assets: In accordance with SFAS ( SFAS ) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, UCN evaluates the carrying value of long-lived assets, including intangibles, when events or circumstances indicate the existence of a possible impairment, based on projected undiscounted cash flows, and recognizes impairment when such cash flows will be less than the carrying values. Measurement of the amounts of impairments, if any, is based upon the difference between carrying value and fair value. Events or circumstances that could indicate the existence of a possible impairment include obsolescence of the technology, an absence of market demand for the product, and/or continuing technology rights protection. Management believes the net carrying amount of long-lived assets will be recovered by future cash flows generated by commercialization of the technology related to the long-lived asset and from cash flows generated from customer lists. Essentially all assets are pledged as collateral for the outstanding debt listed in Note 8.

Stock-Based Compensation: On January 1, 2006, UCN adopted SFAS No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123(R)) which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors including employee stock options based on estimated fair values. SFAS 123(R) supersedes previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) for periods beginning in fiscal year 2006. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) providing supplemental implementation guidance for SFAS 123(R). The provisions of SAB 107 were applied in the adoption of SFAS 123(R).

SFAS 123(R) requires companies to estimate the fair value of stock-based awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Condensed Consolidated Statements of Operations. UCN adopted SFAS 123(R) using the modified prospective transition method which requires the application of the accounting standard starting from January 1, 2006. The Condensed Consolidated Financial Statements, as of and for the three and six months ended June 30, 2006, reflect the impact of SFAS 123(R). Stock-based compensation expense for the three and six months ended June 30, 2006, was \$144,000 and \$297,000, respectively.

Prior to the adoption of SFAS 123(R), UCN accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). Under the intrinsic value method, no stock-based compensation expense for employee stock options had been recognized in our Condensed Consolidated Statements of Operations, because the exercise price of stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant. In accordance with the modified prospective transition method we used in adopting SFAS 123(R), our results of operations prior to 2006 have not been restated to reflect, and do not include, the possible impact of SFAS 123(R). Stock-based compensation expense recognized during a period is based on the value of the portion of stock-based awards that is ultimately

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expected to vest during the period. Stock-based compensation expense recognized in the three and six months ended June 30, 2006, included compensation expense for stock-based awards granted prior to, but not yet vested as of December 31, 2005, based on the fair value on the grant date estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for the stock-based awards granted subsequent to December 31, 2005, based on the fair value



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on the grant date estimated in accordance with the provisions of SFAS 123(R). As stock-based compensation expense recognized in the results for the second quarter of 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Prior to 2006, UCN accounted for forfeitures as they occurred for the purposes of pro forma information under SFAS 123, as disclosed in our notes to Consolidated Financial Statements for the related periods.

Upon adoption of SFAS 123(R), UCN selected the Black-Scholes option pricing model as the most appropriate method for determining the estimated fair value for stock-based awards. The Black-Scholes model requires the use of highly subjective and complex assumptions which determine the fair value of stock-based awards, including the option's expected term and the price volatility of the underlying stock. Volatility is based on historical stock prices over the contractual life of the option. UCN has issued stock options to employees under share-based compensation plans including the Long-term incentive stock plan (LTISP) and those granted by the board of directors and compensation committee. Stock options are issued at the current market price on the date of grant, subject to a three-year vesting period with a contractual term of five years.

On November 10, 2005, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position No. SFAS 123(R)-3 Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards that allows for a simplified method to establish the beginning balance of the additional paid-in capital pool ( APIC Pool ) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC Pool and Condensed Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R). UCN is still in the process of calculating the APIC Pool and have not yet determined if it will elect to adopt the simplified method.

Additional information on stock-based compensation can be found in Note 11.

**Income Taxes:** All income tax amounts reflect the use of the asset and liability method. Under this method, deferred income tax assets and liabilities are determined based on the expected future income tax consequences of temporary differences between the carrying amounts of assets and liabilities for financial and income tax reporting purposes. A valuation allowance is provided to offset deferred income tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred income tax assets will not be realized. To date, a valuation allowance has been recorded to eliminate the net deferred income tax assets.

**Net Loss Per Common Share:** Basic net loss per common share ( Basic LPS ) excludes dilution and is computed by dividing net loss applicable to common shareholders by the weighted average number of common shares outstanding during the year. Diluted net loss per common share ( Diluted LPS ) reflects the potential dilution that could occur if stock options or other common stock equivalents were exercised or converted into common stock. The computation of Diluted LPS is not presented because the exercise or conversion of securities would have an anti dilutive effect on net loss per common share.

**Business Segments and Related Information:** SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for the way public business enterprises are to report information about operating segments in annual financial statements and requires enterprises to report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosure about products and services, geographic areas and major customers. UCN has continued to focus marketing efforts towards providing on-demand contact center software and specialized telecommunications services, in addition to traditional long distance services. Additional information on segments can be found in Note 14.

**Recent Accounting Pronouncements:** In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, ( FIN 48 ) an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation requires that UCN recognize in the financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. The provisions of FIN 48 are effective beginning January 1, 2007 with the cumulative effect of the change in accounting principle recorded as an adjustment to the opening balance of retained earnings. UCN is currently evaluating the impact of adopting FIN 48 on the financial statements.

**Other Comprehensive Loss:** There were no components of other comprehensive loss other than net loss.

**Table of Contents****NOTE 2 RESTRICTED CASH**

UCN's previous line of credit placed restrictions on certain cash balances maintained in the lock-box. The line of credit was terminated in May 2006, which eliminated the lock-box requirement and released these restrictions (Notes 4 and 8). The remaining balance is held on deposit for credit card processing.

**NOTE 3 INTANGIBLE ASSETS**

Intangible assets consisted of the following (in thousands):

	June 30, 2006			December 31, 2005		
	Gross Assets	Accumulated Amortization	Intangible assets, net	Gross Assets	Accumulated Amortization	Intangible assets, net
Customer lists acquired	\$ 15,684	\$ 11,276	\$ 4,408	\$ 15,684	\$ 9,677	\$ 6,007
Technology and patents	7,980	3,541	4,439	7,980	2,545	5,435
Non-compete agreement	154	90	64	154	51	103
	\$ 23,818	\$ 14,907	\$ 8,911	\$ 23,818	\$ 12,273	\$ 11,545

**NOTE 4 LINE OF CREDIT**

In May 2006, UCN entered into an agreement with ComVest Capital, LLC, which included a \$4.5 million convertible term note and a \$7.5 million revolving credit note. UCN used a portion of the proceeds from these notes to repay the outstanding balance and to terminate the outstanding line of credit. There is no lock-box requirement with the revolving credit note and the entire balance is due at the end of the four year term, therefore, the entire amount is classified as long-term as described in Note 8.

**NOTE 5 OTHER ASSETS**

In conjunction with the debt financing completed in May 2006 (Note 8), UCN recorded \$186,000 of deferred financing costs. These costs are being amortized using the interest method. The bulk of these costs are closing fees paid to ComVest Capital of \$158,000. UCN amortized a total of \$5,000 of deferred financing costs during the second quarter 2006.

**NOTE 6 ACCRUED LIABILITIES**

Accrued liabilities consisted of the following (in thousands):

	June 30, 2006	December 31, 2005
Accrued payphone and carrier charges	\$ 791	\$ 660
Accrued payroll and other compensation	640	633
Current portion operating lease obligations assumed	306	436
Assumed acquisition liabilities	95	158
Other	272	381
	\$ 2,104	\$ 2,268

**NOTE 7 FAIR VALUE OF FIXED RATE DEBT**

The following disclosure of the estimated fair value of UCN's financial instruments is made in accordance with the requirements of SFAS No. 107, Disclosures about Fair Value of Financial Instruments. The estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop

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the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of June 30, 2006 and December 31, 2005. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

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The estimated fair value and carrying value of fixed rate debt is as follows (in thousands):

	June 30, 2006		December 31, 2005	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Convertible term note	\$ 3,380	\$ 3,247	\$ 5,789	\$ 5,801
Promissory notes	\$	\$	\$ 325	\$ 325
Capital leases	\$ 1,308	\$ 1,297	\$ 2,363	\$ 2,384

**NOTE 8 LONG-TERM DEBT, NOTES PAYABLE AND CAPITAL LEASES**

Long-term debt, notes payable and capital leases consist of the following (in thousands):

	June 30, 2006	December 31, 2005
Unsecured note payable to the Chairman of the Board, bearing interest at 12 percent payable monthly	\$	\$ 75
Unsecured note payable to a former Director bearing interest at 12 percent, payable monthly, due January 2006, and convertible to common stock at \$2.00 per share.		250
Promissory notes payable to two former MyACD stockholders, interest imputed at 8.25 percent, payable monthly, secured by MyACD common stock. Variable principal payments due monthly, based on MyACD service revenue, final principal payments due January 2008		3,713
Promissory note payable to a former MyACD stockholder, interest imputed at 8.25 percent, payable monthly, secured by MyACD common stock. Principal payments due monthly, final principal payment due December 2007		249
Promissory note payable to Transtel Communications, Inc. and subsidiaries bearing interest at 8 percent, principal and interest payable monthly, secured by certain of the assets acquired from payment due June 2008		1,827
Convertible term note to ComVest Capital, LLC of \$4.5 million, bearing interest at a fixed 9.0 percent, there are no principal payments due through April 2007 after which the loan requires monthly principal and interest payments of \$125,000 with any unpaid amounts due on May 2010, outstanding principal amount is convertible to common stock at \$3.00 per share	3,380	
Revolving credit note with ComVest Capital, LLC, with maximum availability of \$7.5 million, bearing interest at a fixed 9.0 percent, there are no requirements to repay outstanding principal payments until May 2010	3,991	
Capital Leases	1,308	2,363
	8,679	8,477
Current portion of long-term debt	(710)	(2,966)
Debt discounts on convertible term note and revolving credit note	(520)	
	\$ 7,449	\$ 5,511

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In May 2006, UCN entered into an agreement with ComVest Capital, LLC, which included a \$4.5 million convertible term note and a \$7.5 million revolving credit note. These notes are secured by essentially all assets and have certain financial and non-financial covenants of which UCN was in compliance as June 30, 2006. As part of the agreement, UCN issued five-year detachable warrants to purchase 330,000 shares of common stock at \$2.75 per share. UCN allocated \$542,000 of the proceeds from the offering to the warrants based on the relative fair value of the warrants in relation to the fair value of the convertible term note and revolving credit note.

As required by APB 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (APB 14), UCN allocated total debt proceeds based on the respective fair value of the securities issued. Based on the allocation of proceeds, UCN recorded a discount on the convertible term note of \$210,000 based on its relative fair value to the warrant and revolving credit note. The discount is amortized to interest expense using the interest method over the life of the note. Interest expense of \$12,000 was recorded in the second quarter 2006.

The revolving credit note matures in May 2010, accrues interest at a fixed nine percent and provides for maximum availability of \$7.5 million. UCN is required to make monthly interest payments and the entire balance is due at maturity. There was \$3.2 million of unused commitments at June 30, 2006 under the revolving credit note. In conjunction with the allocation of proceeds, UCN recorded a discount on the revolving credit note of \$332,000 based on its relative fair value to the warrant and convertible term note. The discount is amortized to interest expense using the straight-line method over the life of the note. Interest expense of \$10,000 was recorded in the second quarter 2006.

UCN recognized a loss on early extinguishment of debt of \$364,000 in conjunction with completing the ComVest financing. Lower payoff amounts were negotiated with certain note holders that resulted in a gain of \$348,000 from early extinguishment of debt. The gain was offset by the write-off of \$334,000 in deferred debt financing fees, a \$300,000 early termination fee paid to the holder of the previous line of credit, and a \$77,000 difference in the book basis due to imputed interest on notes issued to former shareholders of MyACD.

In conjunction with private placement of common stock that closed during May 2006, UCN was required to repay \$1.1 million of the outstanding convertible term note balance in June 2006 (Note 10).

During March 2006, UCN entered into a capital lease agreement with an equipment finance company for new computer equipment and related software totaling \$196,000 in conjunction with network expansion activities.

**NOTE 9 RELATED PARTY TRANSACTIONS**

During the three and six months ended June 30, 2006 UCN paid the Chairman of the Board of Directors (Chairman), \$5,000 per month for consulting, marketing, and capital raising activities. The Chairman has also provided certain vendors with his personal guaranty in the amount of up to \$800,000, for which UCN has agreed to indemnify the Chairman for any losses for which he may become liable.

In June 2006, UCN repaid a \$75,000 unsecured note to the Chairman of the Board of Directors.

In January 2006, UCN repaid a \$250,000 convertible note to a former director and significant shareholder.

**NOTE 10 CAPITAL TRANSACTIONS**

During May 2006, UCN sold 1.96 million shares of common stock at \$2.30 per share for a total of \$4.5 million to two institutional and accredited investors. Net proceeds of the offering after placement fees and expenses were approximately \$4.2 million, including \$250,000 of sales commissions paid to an investment banking firm.

As part of the convertible term note and revolving credit note agreement, UCN issued detachable five-year warrants to ComVest Capital, LLC to purchase 330,000 shares of common stock at \$2.75 per share. The fair market value of the warrants, using the Black-Scholes pricing model, was \$567,000 with an assumed expected volatility of 73.73%, a risk-free rate of return of 4.98%, no dividend yield, and an expected life of 5 years. On June 23, 2006, a registration statement was filed with the SEC on Form S-1 to register these shares. On July 13, 2006, UCN filed an amended registration statement with the SEC on Form S-1/A. The registration statement became effective on July 17, 2006.

APB 14 requires UCN to allocate the proceeds received on the debt financing to the convertible term note, revolving credit note and detachable warrants on a prorated basis based on the fair value of the respective instruments. Based on the relative fair value of the instruments, UCN allocated \$542,000 to the detachable warrants issued to ComVest.



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During the second quarter of 2006, a former employee exercised options to purchase a total of 65,788 shares of common stock and UCN received total proceeds of \$131,000. During the first quarter of 2006, a former employee exercised options to purchase a total of 5,000 shares of common stock and UCN received total proceeds of \$10,000.

**NOTE 11 STOCK-BASED COMPENSATION**

SFAS 123(R) requires companies to estimate the fair value of stock-based awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods. UCN adopted SFAS 123(R) using the modified prospective transition method which requires the application of the accounting standard starting from January 1, 2006. The Condensed Consolidated Financial Statements, for the three and six months ended June 30, 2006, reflect the impact of SFAS 123(R). In the second quarter of 2006, the adoption of SFAS 123(R) resulted in stock-based compensation expense of approximately \$144,000 using a post-vest forfeiture rate of 5.3% for total stock-based compensation of \$297,000 through June 30, 2006. UCN has allocated the compensation to the respective departments based on location of where the employee's regular compensation is charged as follows (in thousands):

	<b>For the period ended June 30, 2005</b>	
	<b>Three Months</b>	<b>Six Months</b>
Costs of revenue	\$ 1	\$ 3
Selling and promotion	65	134
General and administrative	78	160
<b>Total</b>	<b>\$ 144</b>	<b>\$ 297</b>

Prior to the adoption of SFAS 123(R), UCN accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under SFAS 123. Under the intrinsic value method, no stock-based compensation expense for employee stock options had been recognized in our Condensed Consolidated Statements of Operations, because the exercise price of stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant. In accordance with the modified prospective transition method we used in adopting SFAS 123(R), our results of operations prior to 2006 have not been restated to reflect, and do not include, the possible impact of SFAS 123(R). The following table illustrates the effects on net loss applicable to common stockholders and loss per share if compensation expense was measured using the fair value recognition provision of SFAS No. 123 for the three and six months ended June 30, 2005 (in thousands):

	<b>Three Months</b>	<b>Six Months</b>
<b>Net loss applicable to common stockholders:</b>		
As reported	\$ (1,797)	\$ (3,814)
Pro forma stock-option based compensation	(112)	(272)
<b>Pro forma net loss applicable to common stockholders</b>	<b>\$ (1,909)</b>	<b>\$ (4,086)</b>
<b>Weighted average common shares outstanding</b>		
Basic and diluted as reported	20,783	20,146
<b>Net loss per common share</b>		
Basic and diluted as reported	\$ (0.09)	\$ (0.19)
Basic and diluted pro forma	\$ (0.09)	\$ (0.20)

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UCN estimated the fair value of options granted under our employee stock-based compensation arrangements at the date of grant using the Black-Scholes model with the following weighted-average assumptions for the six months ended June 30, 2006 and 2005:

	June 30, 2006	June 30, 2005
Dividend yield	None	None
Volatility	79%	51%
Risk-free interest rate	4.64%	3.75%
Expected life (years)	4.4	5.0
Weighted average fair value of grants	\$ 1.32	\$ 1.02
Post-vesting forfeiture rate	5.3%	n/a

The following tables summarize all stock option activity during the three month period ended June 30, 2006 (in thousands except per share data):

	Options	Price range	Weighted Average Exercise Price
Balance at April 1, 2006	3,489	\$2.00-\$5.39	\$ 2.36
Granted	50	\$2.26	\$ 2.60
Exercised	(66)	\$2.00	\$ 2.00
Cancelled or expired	(68)	\$2.40-\$2.79	\$ 2.57
<b>Balance at June 30, 2006</b>	<b>3,405</b>	<b>\$2.00-\$5.39</b>	<b>\$ 2.36</b>

The following tables summarize all stock option activity during the six month period ended June 30, 2006 (in thousands except per share data):

	Options	Price range	Weighted Average Exercise Price
Balance at January 1, 2006	3,526	\$2.00-\$5.39	\$ 2.37
Granted	178	\$2.00-\$2.26	\$ 2.16
Exercised	(71)	\$2.00	\$ 2.00
Cancelled or expired	(228)	\$2.00-\$3.69	\$ 2.41
<b>Balance at June 30, 2006</b>	<b>3,405</b>	<b>\$2.00-\$5.39</b>	<b>\$ 2.36</b>

A summary of the options outstanding and options exercisable at June 30, 2006 is as follows (in thousands, except per share amounts):

Exercise price range	Options	Options Outstanding Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable Options Exercisable
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