

Trinsic, Inc.  
Form 10-Q  
November 14, 2005

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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 SEPTEMBER 30, 2005  
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 an accelerated filer (as defined in Rule 12B-2 of the Exchange Act).

Yes  No

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 November 8, 2005 was approximately 17,531,889

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

	(Unaudited) <b>September 30, 2005</b>	<b>December 31, 2004</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 200	\$ 1,363
Accounts receivable, net of allowance for doubtful accounts of \$11,883 and \$10,967	24,924	27,242
Prepaid expenses and other current assets	2,391	836
Total current assets	27,515	29,441
Property and equipment, net	20,587	27,829
Intangible assets, net		457
Other assets	5,295	3,609
Total assets	\$ 53,397	\$ 61,336
<b>Liabilities and Stockholders Deficit</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 48,147	\$ 55,605
Deferred revenue	6,244	6,264
Current portion of long-term debt and capital lease obligations	401	7,536
Asset based loan		12,934
Total current liabilities	54,792	82,339
Long-term deferred revenue		46
Long-term debt and capital lease obligations		33
Total liabilities	54,792	82,418
Commitments and contingencies (Notes 8 and 11)		
Stockholders deficit:		
Common stock, \$0.01 par value; 150,000,000 shares authorized; 17,756,994 and 5,525,361 shares issued; 17,525,058 and 5,518,530 shares outstanding	175	553
Notes receivable from stockholders	(870)	(3,685)
Unearned stock compensation	(435)	(466)

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Additional paid-in capital	417,005	392,488
Accumulated deficit	(417,264)	(409,894)
Treasury stock, 231,936 shares at cost	(6)	(78)
Total stockholders' deficit	(1,395)	(21,082)
Total liabilities and stockholders' deficit	\$ 53,397	\$ 61,336

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

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**TRINSIC, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	<b>For the Three Months Ended September 30,</b>		<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Revenues	\$ 44,030	\$ 60,912	\$ 151,958	\$ 193,176
Operating expenses:				
Network operations, exclusive of depreciation and amortization shown below	23,864	30,427	80,697	95,693
Sales and marketing	2,596	4,788	11,508	14,803
General and administrative	17,014	27,175	58,100	92,297
Restructuring charge		3,223	451	4,030
Depreciation and amortization	2,398	5,032	9,531	15,452
Total operating expenses	45,872	70,645	160,287	222,275
Operating loss	(1,842)	(9,733)	(8,329)	(29,099)
Nonoperating income (expense):				
Interest and other income	806	712	8,100	1,993
Interest and other expense	(3,514)	(1,321)	(7,140)	(4,729)
Total nonoperating income (expense)	(2,708)	(609)	960	(2,736)
Net loss	(4,550)	(10,342)	(7,369)	(31,835)
Less mandatorily redeemable convertible preferred stock dividends and accretion		(5,198)		(13,189)
Less deemed dividend related to beneficial conversion feature		(90)		(183)
Net loss attributable to common stockholders	\$ (4,550)	\$ (15,630)	\$ (7,369)	\$ (45,207)
Weighted average common shares outstanding	5,520,137	753,005	5,493,993	735,570

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Basic and diluted net loss per common share	\$ (0.82)	\$ (20.76)	\$ (1.34)	\$ (61.46)
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The accompanying notes are an integral part of these unaudited consolidated financial statements.

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (7,369)	\$ (31,835)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	9,531	15,452
Provision for bad debts	9,306	5,017
Expense charged for granting of stock options	157	1,255
Change in operating assets and liabilities:		
Increase in accounts receivable	(4,423)	(4,549)
(Increase) decrease in prepaid expenses	(1,555)	5,059
Increase in other assets	(1,686)	(167)
Decrease in accounts payable and accrued liabilities	(5,977)	(1,925)
Decrease in deferred revenue	(66)	(3,546)
Total adjustments	5,287	16,596
Net cash used in operating activities	(2,082)	(15,239)
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(2,206)	(6,258)
Principal repayments received on notes receivable		40
Net cash used in investing activities	(2,206)	(6,218)
<b>Cash flows from financing activities:</b>		
Payments on long-term debt and capital lease obligations	(668)	(4,047)
Principal repayments received on notes receivable issued for stock	250	191
Payment of preferred stock dividends		(3)
Proceeds from (payoff of) asset based loan	(12,934)	12,539
Proceeds from stand by credit facility	13,977	5,000
Proceeds from issuance of preferred stock	2,500	
Proceeds from exercise of stock options and warrants		503
Net cash provided by financing activities	3,125	14,183
Net decrease in cash and cash equivalents	(1,163)	(7,274)
Cash and cash equivalents, beginning of period	1,363	12,013

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Cash and cash equivalents, end of period	\$	200	\$	4,739
Non-cash financing activities:				
Conversion of stand by credit facility and accrued interest into preferred stock	\$	21,585	\$	
Conversion of preferred stock into common stock	\$	24,085	\$	

The accompanying notes are an integral part of these unaudited 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. and subsidiaries ( we or us ) is an emerging provider of advanced, integrated telecommunications services targeted to residential and business subscribers. We provide local and long distance telephone services in combination with enhanced communication features accessible through the telephone, the Internet and certain personal digital assistants. We provide these services in forty-nine states, but our customers are primarily concentrated in six states. We recently began providing services utilizing Internet protocol, often referred to as IP telephony, voice over Internet protocol or VoIP. We provide long-distance telecommunications services nationwide.

We introduced our services on a wholesale basis during the first quarter of 2002. This provides other companies with the opportunity to provide local, long-distance and enhanced telephone service to their own residential and business end user customers on a private label basis by utilizing our telephone exchange services, enhanced services platform, infrastructure and back-office operations.

**LIQUIDITY AND CAPITAL RESOURCES**

The accompanying unaudited 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 on, among other things, the company's ability to operate profitably, to generate cash flow from operations and to obtain funding adequate to fund its business.

We have a limited operating history and our operations are subject to material 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 September 30, 2005, we had an accumulated deficit of approximately \$417.3 million and \$0.2 million in cash and cash equivalents. We have funded our expenditures primarily through operating revenues, private securities offerings, various working capital facilities, our standby credit facility and an initial public offering.

The company's inability to operate profitably and to consistently generate cash flows from operations, its reliance therefore on external funding either from loans or equity raise substantial doubt about the company's ability to continue as a going concern.

For the nine months ended September 30, 2005, net cash used in operating activities was \$2.1 million as compared to \$15.2 million in the prior year period.

In April 2004, the company secured an asset based loan facility with Textron Financial Corporation ( Textron ), which provided up to \$25 million to fund operations. Effective January 27, 2005, we entered into a Modification and Termination Agreement with Textron. Among other things the Modification and Termination Agreement provided that Textron would forbear from exercising default rights and remedies until May 31, 2005, would waive the early termination fee and modify the annual facility fee. We agreed to pay a modification fee of \$150,000.

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. On May 6, 2005, we used proceeds from this accounts receivable financing facility to pay off our loan balance with Textron.

By letter dated May 6, 2005, the Nasdaq Stock Market notified us that the market value of our common stock remained below the minimum of \$35 million required by Marketplace Rule 4310(c)(2)(B)(ii) and accordingly our shares would be delisted from the Nasdaq SmallCap Market at the opening of business on May 17, 2005. We appealed the decision and presented a definitive plan for regaining compliance to a hearing panel. A Nasdaq Listing

Qualifications Hearing Panel granted the company a temporary exception from these requirements subject to the following conditions:

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(1) The company's Form 10-Q for the quarter ended June 30, 2005 must evidence pro forma stockholders' equity of at least \$2,500,000 at June 30, 2005.

(2) The company's Form 10-Q for the quarter ended September 30, 2005 must report actual stockholders' equity at September 30, 2005 of at least \$2,500,000.

(3) On or before September 30, 2005, the company must evidence a closing bid price of at least \$1.00 per share and immediately thereafter a closing bid price of at least \$1.00 per share for a minimum of 10 consecutive trading days. While we satisfied conditions (1) and (3), our stockholders' equity as of September 30, 2005 as indicated by this report was less than \$2,500,000. Accordingly, we may be delisted from the NASDAQ SmallCap Market. This report will serve as notice to the NASDAQ Stock Market, Inc. of our material noncompliance with NASDAQ's rules for continued listing on the NASDAQ SmallCap Market. In that event we expect our shares will begin trading on the OTC Bulletin Board.

On September 23, 2005, our shareholders approved a one-for-ten reverse stock split of our common stock. The reverse stock split was effected on September 26, 2005. Fractional shares were not issued in connection with the reverse stock split. All share and per share amounts have been restated herein to reflect the one-for-ten reverse stock split. A roll-forward of our Stockholders Deficit from December 31, 2004 to September 30, 2005 follows:

	<b>Notes</b>													
	<b>Common Stock</b>		<b>Receivable from Stockholders</b>		<b>Unearned Compensation</b>		<b>Additional Paid-In Capital</b>		<b>Accumulated Deficit</b>		<b>Treasuries</b>		<b>Total Stockholders</b>	
	<b>Shares</b>	<b>Par Value</b>	<b>Stock</b>	<b>holders</b>	<b>Compensation</b>	<b>Capital</b>	<b>Deficit</b>	<b>Stock</b>	<b>Deficit</b>	<b>Stock</b>	<b>Deficit</b>	<b>Stock</b>	<b>Deficit</b>	<b>Stockholders</b>
Balance, December 31, 2004	5,518,530	\$ 55	\$ (3,685)		\$ (466)	\$ 392,488	\$ (409,895)	\$ (78)						\$ (21,581)
Reverse stock split						\$ 427								\$ 427
Forfeiture of stock options		(2)			54	(68)				70				\$ 54
Cash received for notes receivable				250										\$ 250
Impairment on note receivable	(225,000)			2,565						2				\$ 2,567
Restricted Stock Awards	189,144		2			(23)	194							\$ 173
Conversion of Preferred Stock to Common	12,042,384	120					23,964							\$ 24,084
Net income									(7,369)					\$ (7,369)
Balance, September 30, 2005	17,525,058	\$ 175	\$ (870)		\$ (435)	\$ 417,005	\$ (417,264)	\$ (6)						\$ (1,395)

Effective September 30, 2005, our chief operating officer, Frank Grillo has resigned to pursue other opportunities. No replacement chief operating officer has been appointed. Instead our chief executive officer, Horace J. Trey Davis, III, will take over Mr. Grillo's duties.

Our net cash used in investing activities decreased by \$4.0 million to \$2.2 million for the nine months ended September 30, 2005, compared to \$6.2 million the prior year period. The reduction was attributable to the purchasing of less property and equipment during the nine months ended September 30, 2005 as compared to the same period in the prior year.

For the nine months ended September 30, 2005, net cash provided by financing activities was \$3.1 million as compared to \$14.2 million for the prior year period. This change is primarily the result of using proceeds from our accounts receivable financing facility to payoff our asset based loan with Textron.

## 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, 2004, included in our Annual Report on Form 10-K filed with the SEC on April 15, 2005. The balance sheet at December 31, 2004 was derived from audited financial statements for the year ended December 31, 2004. In the opinion of management, all adjustments considered necessary for a fair statement have been included. Operating results for the three and nine month periods ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

**RECLASSIFICATION**

Certain amounts in the consolidated statements of operations for the three and nine months ended September 30, 2004 have been reclassified to conform to the presentation for the three and nine months ended September 30, 2005.

**3. SIGNIFICANT ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS**

**Table of Contents****(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, 2004.

Effective January 1, 2005, we have deferred the fee charged to us by the Incumbent Local Exchange Carriers ( ILECs ) in the activation of our business VoIP customers. This fee and any acquisition revenue received from the customers are being deferred and amortized over the life of each customer's signed contract. At September 30, 2005, unamortized deferred set up fees amounted to \$0.6 million.

Property and equipment are recorded at historical cost and depreciation and amortization are calculated on a straight-line basis over the assets' useful lives. If all other factors were to remain unchanged, we expect that a one-year change (increase or decrease) in the useful lives of the three largest categories of our property and equipment (which accounts for approximately 72% of our total property and equipment in service) would result in a increase or decrease of between \$1.4 million and \$1.6 million in our year to date 2005 depreciation expense.

**(b) Recent Accounting Pronouncements**

In May 2005, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 154, Accounting Changes and Error Corrections, which is effective beginning on January 1, 2006. SFAS No. 154 requires that all voluntary changes in accounting principles are retrospectively applied to prior financial statements as if that principle had always been used, unless it is impracticable to do so. When it is impracticable to calculate the effects on all prior periods, SFAS No. 154 requires that the new principle be applied to the earliest period practicable. The adoption of SFAS No. 154 is not anticipated to have a material effect on our financial position or results of operations.

In March 2005, the FASB issued Interpretation Number 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143 ( FIN 47 ). FIN 47 clarifies the term conditional asset retirement obligation as used in Statement of Financial Accounting Standards ( SFAS ) No. 143, Accounting for Asset Retirement Obligations, and also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. We do not anticipate that the implementation of FIN 47 will have a material impact on our financial position, results of operations or cash flows.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payments ( SFAS No. 123R ). SFAS No. 123R requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and measurement based on the grant-date fair value of the award. It requires the cost to be recognized over the period during which an employee is required to provide service in exchange for the award. Additionally, compensation expense will be recognized over the remaining employee service period for the outstanding portion of any awards for which compensation expense had not been previously recognized or disclosed under SFAS No. 123, Accounting for Stock-Based Compensation ( SFAS No. 123 ). SFAS No. 123R replaces SFAS No. 123 and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB No. 25 ), and its related interpretations.

SFAS No. 123R was originally required to be adopted beginning no later than the third quarter of 2005. However, in April 2005, the Securities and Exchange Commission announced the adoption of a new staff accounting bulletin that amends the compliance dates for SFAS No. 123R. Accordingly, we are required to adopt SFAS No. 123R no later than January 1, 2006. We are currently assessing the timing and impact of adopting SFAS No. 123R.

**4. STANDBY CREDIT FACILITY**

During the first quarter of 2005, we received advances of \$3.5 million, \$2.5 million and \$1.2 million on February 14, 2005, March 4, 2005 and March 24, 2005, respectively, from our standby credit facility with The 1818 Fund III, LP. (the Fund ). During the second quarter of 2005, we received advances of \$1.3 million, \$2.5 million and \$2.5 million on May 9, 2005, May 24, 2005 and June 10, 2005, respectively.

On July 15, 2005, we entered into an Exchange and Purchase Agreement with the Fund. In the Exchange and Purchase Agreement, we agreed to issue to the Fund 24,084,769 shares of Series H Convertible Preferred Stock in exchange for all (approximately \$21.6 million) outstanding indebtedness (including principal, interest and premium) owing to the Fund under a promissory note due in March 2006 and \$2.5 million in cash. We consummated the exchange and purchase immediately after executing the agreement. We sold the Series H Convertible Preferred Stock

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in private placement pursuant to the exemption from registration afforded by Section 4(2) of the Securities Act of 1933. All of the Series H Convertible Preferred Stock was converted into 12,042,384 shares of common stock on September 30, 2005.

**Table of Contents****5. ACCOUNTS RECEIVABLE AGREEMENT**

On April 4, 2005, we entered into an accounts receivable financing agreement with Thermo Credit, LLC ( Thermo ) to replace our Textron credit facility. 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. The discount rate is 2.5%. Purchase of the receivables is at the option of Thermo. On May 6, 2005, we used proceeds from this accounts receivable financing facility to pay off our loan balance with Textron.

**6. RESTRUCTURING CHARGE**

On April 6, 2005, we initiated a reduction in force which terminated the employment of approximately 107 of our employees. We incurred a one-time charge during April of approximately \$450,000 consisting primarily of post termination wages, salaries and the associated payroll taxes, net of vacation expense already accrued for these employees. Substantially all of these post termination wages were paid within 30 days following the reduction in force.

All restructuring charges have been paid as of September 30, 2005. The following table shows the restructuring charges and related accruals recognized under the restructuring plan described above and in the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2004 and the effect on our consolidated financial position:

	<b>Employee Termination Benefits</b>	<b>Lease Abandonment Costs</b>	<b>Asset Retirement</b>	<b>Total</b>
Balance at December 31, 2002	\$	\$ 551	\$	\$ 551
Cash paid		(200)		(200)
Balance at December 31, 2003		351		351
Plan Charges	4,527	234	40	4,801
Cash paid	(3,646)	(262)		(3,908)
Asset disposal			(40)	(40)
Converted to note payable		(40)		(40)
Lease termination settlement reversal		(210)		(210)
Balance at December 31, 2004	881	73		954
Plan Charges	451			451
Vacation Accrual	91			91
Cash paid	(1,423)	(73)		(1,496)
Balance at September 30, 2005	\$	\$	\$	\$

**7. STOCK BASED COMPENSATION**

For employee stock options, the FASB issued SFAS No. 123, *Accounting for Stock-Based Compensation* requiring entities to recognize as an expense, over the vesting period, the fair value of the options or utilize the accounting for employee stock options used under APB 25. We apply the provisions of APB 25 and consequently recognize compensation expense over the vesting period for grants made to employees and directors only if, on the measurement date, the market price of the underlying stock exceeds the exercise price. We provide the pro forma net income and earnings per share disclosures as required under SFAS No. 123 for grants made as if the fair value method defined in SFAS No. 123 had been applied. We recognize expense over the vesting period of the grants made to non-employees utilizing the Black-Scholes stock valuation model to calculate the value of the option on the measurement date.

The following table illustrates, in accordance with the provisions of SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure, an Amendment of SFAS 123, Accounting for Stock-Based Compensation*, the effect on net income (loss) and earnings per share if we had applied the fair value recognition provisions of SFAS

No. 123, to stock-based employee compensation.

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	For the three months ended September 30,		For the nine months ended September 30,	
	2005	2004	2005	2004
Net loss attributable to common stockholders, as reported	\$ (4,550)	\$ (15,630)	\$ (7,369)	\$ (45,207)
Add: Stock based compensation included in net loss	64	367	157	1,255
Deduct: Total stock based employee compensation determined under the fair value based method for all awards	(577)	(744)	(1,856)	(2,543)
Net loss attributable to common stockholders, pro forma	\$ (5,063)	\$ (16,007)	\$ (9,068)	\$ (46,495)
Basic and Diluted Net Loss per Common Share				
As reported	\$ (0.82)	\$ (20.76)	\$ (1.34)	\$ (61.46)
Pro forma	\$ (0.92)	\$ (21.26)	\$ (1.65)	\$ (63.21)

We calculated the fair value of each grant on the date of grant using the Black-Scholes option pricing model. In addition to there being no payments of dividends on our common stock, the following assumptions were used for each respective period:

	For the three months ended September 30,		For the nine months ended September 30,	
	2005	2004	2005	2004
Discount Rate	4.0%	N/A	4.0%	3.1%
Volatility	99.1%	N/A	99.1%	98.3%
Average Option Expected Life	5 years	5 years	5 years	5 years

Incremental shares of common stock equivalents are not included in the calculation of net loss per share as the inclusion of such equivalents would be anti-dilutive.

**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 September 30, 2005, the total disputed amounts was approximately \$18.4 million of which we have accrued \$11.4 million. We believe that we have adequately accrued for our disputes and we believe our maximum exposure for these charges is \$18.4 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.

We currently have agreements with two 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.

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 connection with certain of our wholesale services agreements, a portion of customers are provisioned using our company code. Therefore, we are the customer of record for the Regional Bell Operating Companies' wholesale billing. It is very likely that the state commissions would require us to continue providing services to our wholesale customers for at least a 90-day period, regardless of whether our wholesale relationships continue.

We have agreed to certain service level agreements (SLAs) for providing service under our wholesale agreements. If we were to not fulfill the SLAs after the phase-in period there are certain remedies including but not limited to financial compensation. We have not had to pay or accrue any financial compensation as a result of any SLAs since our inception.

**Table of Contents****9. RELATED PARTY TRANSACTIONS**

On September 29, 2004, we signed an agreement with SipStorm, Inc., a company owned by two of our shareholders and former officers of our company to transfer selected computer hardware, software and intellectual property rights to SipStorm. Relative to the purchase, SipStorm assumed responsibility for certain accounts payable, future maintenance payments and provided a promissory note in the amount of \$2.8 million. The promissory note was settled during the second quarter of 2005 for a cash payment of \$250,000 and the assignment to us of 813,404 shares of Trinsic common stock. The note was collateralized by shares of our common stock owned by the directors of SipStorm and \$250,000 reflected the estimated realizable value of that portion of the note not secured by our common stock at the time of the settlement. In anticipation of the settlement, \$2.5 million in bad debt expense was booked during the first quarter of 2005.

**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:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Basic and diluted net loss per share:</b>				
Net loss	\$ (4,550)	\$ (10,342)	\$ (7,369)	\$ (31,835)
Less mandatorily redeemable convertible preferred stock dividends and accretion		(5,198)		(13,189)
Less deemed dividend related to beneficial conversion feature		(90)		(183)
 Net loss attributable to common stockholders	 \$ (4,550)	 \$ (15,630)	 \$ (7,369)	 \$ (45,207)
 Weighted average common shares outstanding	 5,520,137	 753,005	 5,493,993	 735,570
 Basic and diluted net loss per share	 \$ (0.82)	 \$ (20.76)	 \$ (1.34)	 \$ (61.46)

Basic and diluted net loss per share are the same for each of the periods presented. The following table includes potentially dilutive items that were not included in the computation of diluted net loss per share for all periods presented because to do so would be anti-dilutive in each case:

	<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
Unexercised stock options	102,808	232,677
Unexercised warrants	107,878	197,426
Mandatorily redeemable preferred stock convertible into common shares		725,525

Total potentially dilutive shares of common stock equivalents	210,686	1,155,628
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#### 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

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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. We believe we are entitled to indemnification from our Underwriters.

A settlement has been reached by the respective lawyers for 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. The court has given preliminary approval of the settlement subject to certain modifications. A revised settlement agreement has been submitted to the court. To be binding, the settlement must be executed by the parties and thereafter submitted to and approved by the court. The settlement will not be binding upon any plaintiffs electing to opt-out of the settlement.

Susan Schad, on behalf of herself and all others similarly situated, filed a class action lawsuit against us on May 13, 2004. The lawsuit alleges that we 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 complaint seeks to certify a class of plaintiffs consisting of all persons or entities who contracted with us for telecommunications services and were billed for particular taxes or regulatory fees. The complaint asserts a claim under the Illinois Consumer Fraud and Deceptive Business Practices Act and seeks 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 our 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 within 28 days) 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. While the partial dismissal with prejudice is a positive development, and although we believe the plaintiff's allegations are without merit and intend to defend the lawsuit vigorously, 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 \$180,000. 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 expect to resolve this dispute.

## **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 provide these services in forty-nine states, but our customers are concentrated primarily in metropolitan areas within six states. This segment also includes our Touch 1 residential long-distance offering that is available on a nation wide basis.

The wholesale services segment allows companies to offer telephone exchange and enhanced services on a private label basis to residential and small business customers. Sprint is our sole customer within this segment of our business.

As discussed in Note 13. Subsequent Events, we have entered into an agreement to acquire the Sprint lines for which we currently provide services on a wholesale basis. Upon the completion of this transaction on February 1, 2006 we will no longer have a wholesale business and will discontinue segment reporting.

Management evaluates the performance of each business unit based on segment results, after making adjustments for unusual items. 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.

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The following summarizes the financial information concerning our reportable segments for the three and nine months ended September 30, 2005 and 2004:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Retail Services</b>				
Revenues	\$ 34,045	\$ 41,229	\$ 118,378	\$ 129,347
Depreciation and amortization	\$ 2,374	\$ 4,994	\$ 9,423	\$ 14,744
Segment results	\$ (2,873)	\$ (9,337)	\$ (9,045)	\$ (27,468)
Capital expenditures	\$ 573	\$ 1,567	\$ 2,206	\$ 6,218
Identifiable assets			\$ 47,675	\$ 51,420

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Wholesale Services</b>				
Revenues	\$ 9,984	\$ 19,683	\$ 33,580	\$ 63,829
Depreciation and amortization	\$ 24	\$ 38	\$ 108	\$ 708
Segment results	\$ 3,428	\$ 4,636	\$ 10,247	\$ 13,822
Capital expenditures	\$	\$	\$	\$ 40
Identifiable Assets			\$ 5,722	\$ 13,225

The following table reconciles our segment information to the consolidated financial information for the three and nine months ended September 30, 2005 and 2004:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
<b>Segment results:</b>				
Total segment results	\$ 556	\$ (4,701)	\$ 1,202	\$ (13,647)
Depreciation and amortization	(2,398)	(5,032)	(9,531)	(15,452)
Total consolidated operating loss	\$ (1,842)	\$ (9,733)	\$ (8,329)	\$ (29,099)

**13. SUBSEQUENT EVENTS**

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 October 26, 2005 we entered into a definitive agreement to acquire from Sprint Nextel Corp. (NYSE:S) substantially all of Sprint Nextel's local access lines for which we currently provide services under a wholesale private-label arrangement. As of November 1, 2005 we provided wholesale services for approximately 160,000 local lines belonging to Sprint Nextel Corp. Of these, approximately 145,000 are currently deemed active accounts billable to a retail end-user while the remainder are in bill suspend status for various reasons such as non-payment, change in customer premises, etc. We expect the total number of lines will be lower at closing because of normal attrition. The closing is anticipated for early 2006, pending regulatory approval and the satisfaction of customary closing conditions. The Agreement sets the purchase price at \$100 per each line that is active and billable to a Sprint Nextel retail end-user (subject to certain adjustments to account for excess line attrition), of which 25% will be due at closing. The remainder will be due in 15 equal monthly installments. As of October 31, 2005, we had escrowed approximately \$970,000 of the amount due at closing.

On October 31, 2005 we entered into a long-term commercial agreement with the incumbent local exchange carrier (ILEC) subsidiaries of SBC Communications Inc. The contract will allow Trinsic to continue providing its traditional

local voice services in the SBC telephone companies' service territories for five years. The SBC telephone companies' service territories span 13 states in the Midwest, Southwest and Western U.S., including Illinois, Texas and California. Under the contract, the SBC companies will provide Trinsic with their Local Wholesale Complete product as a replacement to today's Unbundled Network Element Platform, often referred to as UNE-P. Local Wholesale Complete offers Trinsic use of the same network elements, features and functions as Trinsic purchases today from the SBC telephone companies under the UNE-P regime. The transition from UNE-P to Local Wholesale Complete will be seamless for the customer and will result in no material costs for Trinsic. There are no minimum volume commitments included in the agreement.

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

You should read the following discussion together with the Selected Consolidated Financial Data, 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 Risks Related to our Financial Condition and our Business included in our Form 10-K filed with the Securities and Exchange Commission on April 15, 2005, 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, 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, success and profitability of our wholesale services, dependence on key personnel, uncertainty of government regulation, legal and regulatory uncertainties, access to capital markets, and competition. We disclaim any obligation to update information contained in any forward-looking statement.

**OVERVIEW**

We are an emerging provider of advanced, integrated telecommunications services targeted to residential and business customers. 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 have successfully deployed Cisco soft switches in the Tampa and New York City markets and intend to target multi-line business customers with our converged IP telephony services. We also intend to use these soft switches to serve consumers as we continue to deploy broadband loop concentrators into central offices. We provide our services on both a retail (i.e. directly to end user customers) and 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. The nature of our business is rapidly evolving, and we have a limited operating history.

In evaluating our financial condition and operating performance the most important matters on which we focus are lines under management, revenue per unit, cost per unit, bad debt expense, expenses as a percentage of revenues and results by segment. These measures and other analyses are discussed in detail throughout the following paragraphs and provide insight into how we analyze and review our business.

**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.

**Table of Contents****Revenues**

Total revenues by segment (in millions)	For the three months ended September 30,		Percentage of Revenues	
	2005	2004	2005	2004
Retail Segment	\$ 34.0	\$ 41.2	77.3%	67.7%
Wholesale segment	10.0	19.7	22.7%	32.3%
<b>Total Revenues</b>	<b>\$ 44.0</b>	<b>\$ 60.9</b>	<b>100.0%</b>	<b>100.0%</b>

Total revenues by segment (in millions)	For the nine months ended September 30,		Percentage of Revenues	
	2005	2004	2005	2004
Retail Segment	\$ 118.4	\$ 129.3	77.9%	67.0%
Wholesale segment	33.6	63.8	22.1%	33.0%
<b>Total Revenues</b>	<b>\$ 152.0</b>	<b>\$ 193.2</b>	<b>100.0%</b>	<b>100.0%</b>

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:

Type of Service	Average lines in service for the three months ended September 30,		Average lines in service for the nine months ended September 30,	
	2005	2004	2005	2004
Bundled residential services	132,436	172,197	154,453	183,904
Bundled business services	44,121	46,869	45,259	34,409
1+ long distance services	34,509	46,826	36,742	59,310
Wholesale services	192,942	346,165	236,552	316,621
VoIP	5,288		3,457	
<b>Total lines under management</b>	<b>409,294</b>	<b>612,057</b>	<b>476,461</b>	<b>594,244</b>

Type of Service	Ending lines in service as of September 30,	
	2005	2004
Bundled residential services	120,262	163,050
Bundled business services	43,218	47,224
1+ long distance services	33,090	44,200
Wholesale services	173,460	336,418
VoIP	5,357	
<b>Total lines under management</b>	<b>375,387</b>	<b>590,892</b>

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 businesses, 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:

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	For the three months ended September 30,		For the nine months ended September 30,	
	2005	2004	2005	2004
Average revenue per unit in service				
Bundled residential services	\$70.67	\$66.42	\$71.62	\$66.68
Bundled business services	\$35.10	\$36.52	\$36.05	\$42.84
1+ long distance services	\$12.76	\$12.70	\$12.52	\$10.72

During the remainder of 2005 we expect to experience some overall reduction in consumer line count. We will continue to focus the majority of our marketing efforts in the Northeast. We still anticipate that our consumer base will account for the largest portion of our overall revenue stream and our operating cash flow over the full year. We will also continue to focus on building our IP telephony business customer base largely focused on the New York and Tampa metropolitan market areas as liquidity allows. Our VoIP offerings may provide additional revenues, but will not contribute meaningfully to positive operations or be of a significant nature until at least the second half of 2006. Additionally we will continue to deploy facilities aimed at serving the consumer market segment as resources permit and look to migrate customers to our own network at a moderate pace.

*Retail Segment*

Retail segment revenues by type (in millions)	For the three months ended September 30,		Percentage of Revenues	
	2005	2004	2005	2004
Bundled residential services	\$ 28.1	\$ 34.3	82.5%	83.2%
Bundled business services	4.6	5.1	13.6%	12.5%
1+ long-distance services	1.3	1.8	3.9%	4.3%
Total Revenues	\$ 34.0	\$ 41.2	100.0%	100.0%

Retail segment revenues by type (in millions)	For the nine months ended September 30,		Percentage of Revenues	
	2005	2004	2005	2004
Bundled residential services	\$ 99.6	\$ 110.4	84.1%	85.3%
Bundled business services	14.7	13.3	12.4%	10.3%
1+ long-distance services	4.1	5.7	3.5%	4.4%
Total Revenues	\$ 118.4	\$ 129.3	100.0%	100.0%

During the three and nine months ended September 30, 2005, the decrease in retail revenue as compared to the same periods in 2004 was primarily the result of the decline in residential UNE-P lines and 1+ long distance lines.

**Table of Contents***Wholesale Segment*

Wholesale segment revenues by type (in millions)	For the three months ended September 30,		Percentage of Revenues	
	2005	2004	2005	2004
Sprint	\$ 10.0	\$ 18.8	100.0%	95.4%
MCI		0.1	0.0%	0.5%
Other		0.8	0.0%	4.2%
Total Revenues	\$ 10.0	\$ 19.7	100.0%	100.0%

Wholesale segment revenues by type (in millions)	For the nine months ended September 30,		Percentage of Revenues	
	2005	2004	2005	2004
Sprint	\$ 33.6	\$ 62.3	99.9%	97.6%
MCI	0.0	0.2	0.1%	0.4%
Other		1.3	0.0%	2.0%
Total Revenues	\$ 33.6	\$ 63.8	100.0%	100.0%

Sprint lines have decreased significantly from September 30, 2004 to 2005, resulting in a decline in wholesale revenue.

We expect that our wholesale lines in service will continue to decline over the balance of 2005. While revenues are expected to decline as well over this period, the amount of decline may not directly correspond to the reduction in line count. The degree of revenue attrition will be directly tied to the number of departing Sprint end users whose ILEC local service arrangements were billed through Trinsic versus the number of departing Sprint end users whose ILEC local service arrangements were billed directly to Sprint by the ILEC.

We employ the gross accounting method for recognizing revenue within the wholesale service business segment; therefore, where ILEC billings are passed through Trinsic, we record revenue for certain services that we provide to Sprint at our cost and record the off-setting expense in one of the respective operating cost lines within our income statement when we are the primary obligor. These revenues (and cost pass-through items) result in no contribution to operating profit. The largest revenue component that is treated in this manner is the charge from the ILECs, which we record in network operations and general and administrative expense. If the number of our wholesale lines in service declines then the stated accounts payable associated with those lines will decline as well. Therefore, to the extent that departing Sprint end users are concentrated among the base billed for ILEC services through Trinsic, the amount of revenue loss per departing end user will be greater than for departing Sprint end users who are direct billed by the ILEC to Sprint. The direct impact of the loss of Sprint end users upon profitability to Trinsic has no relationship to whether the ILEC bills are passed through Trinsic or direct billed to Sprint.

On October 26, 2005 we entered into a definitive agreement to acquire from Sprint Nextel Corp. (NYSE:S) substantially all of Sprint Nextel's local access lines for which we currently provide services under a wholesale private-label arrangement. As of November 1, 2005 we provided wholesale services for approximately 160,000 local lines belonging to Sprint Nextel Corp. Of these, approximately 145,000 are currently deemed active accounts billable to a retail end-user while the remainder are in bill suspend status for various reasons such as non-payment, change in customer premises, etc. We expect the total number of lines will be lower at closing because of normal attrition. The closing is anticipated for early 2006, pending regulatory approval and the satisfaction of customary closing conditions. The Agreement sets the purchase price at \$100 per each line that is active and billable to a Sprint Nextel retail end-user (subject to certain adjustments to account for excess line attrition), of which 25% will be due at closing. The

remainder will be due in 15 equal monthly installments. As of October 31, 2005, we had escrowed approximately \$970,000 of the amount due at closing.

**Table of Contents****Network Operations**

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

	For the three months ended September 30,		Percentage of Segment Revenues	
	2005	2004	2005	2004
Network operations expense, exclusive of depreciation and amortization expense, by segment (in millions)				
Retail Segment	\$ 18.7	\$ 21.5	54.9%	52.2%
Wholesale Segment	5.2	8.9	51.7%	45.2%
Total Network Operations Expense	\$ 23.9	\$ 30.4	54.2%	50.0%

	For the nine months ended September 30,		Percentage of Segment Revenues	
	2005	2004	2005	2004
Network operations expense, exclusive of depreciation and amortization expense, by segment (in millions)				
Retail Segment	\$ 63.0	\$ 65.8	53.3%	50.9%
Wholesale Segment	17.7	29.9	52.6%	46.8%
Total Network Operations Expense	\$ 80.7	\$ 95.7	53.1%	49.5%

The following table shows the break-down by type of network operations expense:

	For the three months ended September 30,		Percentage of Network Operations	
	2005	2004	2005	2004
Network operations expense, exclusive of depreciation and amortization, by type (in millions)				
Bundled residential services	\$ 15.2	\$ 18.1	63.8%	59.5%
Bundled business services	3.3	3.1	13.7%	10.2%
1+ long distance services	0.2	0.3	0.9%	1.0%
Wholesale services	5.2	8.9	21.7%	29.3%
Total	\$ 23.9	\$ 30.4	100%	100%

	For the nine months ended September 30,		Percentage of Network Operations	
	2005	2004	2005	2004
Network operations expense, exclusive of depreciation and amortization, by type (in millions)				
Bundled residential services	\$ 52.1	\$ 57.8	64.6%	60.5%
Bundled business services	10.2	6.9	12.7%	7.2%

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1+ long distance services	0.7	1.1	0.8%	1.1%
Wholesale services	17.7	29.9	21.9%	31.2%
Total	\$ 80.7	\$ 95.7	100%	100%

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During the three and nine months ended September 30, 2005, network operations expense decreased as compared to the same periods in 2004 for residential, 1+ long distance services and wholesale services primarily because lines in service have also decreased. Network operations expense increased for bundled business services during the three and nine months ended September 30, 2005 as compared to the same periods in 2004 due to increases in ILEC fees.

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 September 30,		For the nine months ended September 30,	
Average network operations expense per unit	2005	2004	2005	2004
Bundled residential services	\$38.32	\$34.99	\$37.51	\$34.95
Bundled business services	\$24.64	\$22.11	\$25.12	\$22.24
1+ long distance services	\$ 2.04	\$ 2.25	\$ 2.04	\$ 1.99

Fluctuations in AEPU are the net result of four offsetting factors: (1) increased usage as a result of our customers choosing our unlimited product which generally results in increased domestic long-distance charges; (2) changes in per line costs as our customer base continues to become more geographically diverse resulting in some changes to the average cost experienced as a result of having more lines in higher or lower priced UNE-P states and zones; (3) our auditing and analysis of network operations and improving the synchronization of our billing systems to help reduce network costs on a per unit basis; and (4) changes in ILEC rates.

We expect AEPU to increase during the remainder of 2005 due to rate increases agreed upon within the commercial services agreements that we have with Verizon, Qwest and SBC. We may be subject to similar rate increases should we enter into additional commercial agreements with other ILECs.

Effective January 1, 2005, we have deferred the fee charged to us by the Incumbent Local Exchange Carriers ( ILECs ) in the activation of our business VoIP customers. This fee and any acquisition revenue received from the customers are being deferred and amortized over the life of each customer's signed contract. At September 30, 2005, unamortized deferred set up fees amounted to \$0.6 million.

**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 September 30,		For the nine months ended September 30,	
Network operations expense as a percentage of revenues	2005	2004	2005	2004
Bundled residential services	54.2%	52.7%	52.4%	52.4%
Bundled business services	70.2%	60.5%	69.7%	51.9%
1+ long distance services	16.0%	17.7%	16.3%	18.6%

During the three and nine months ended September 30, 2005, network operations expense related to bundled residential and bundled business services increased as a percentage of revenues as compared to the same prior year periods due to increased usage, increased ILEC rates, changes in geographic distribution of our customer base and incremental fixed cost structures associated with roll out of our VOIP offering. 1+ long distance services decreased as a percentage of revenues primarily as a result of our auditing and analysis of network operations.



**Table of Contents***Wholesale Segment*

Network operations expense from the wholesale segment decreased for the three and nine months ended September 30, 2005 as compared to the same periods in 2004. Sprint elected to become the customer of record for billing purposes from the ILECs for a significant portion of their total wholesale lines in service. This caused a decrease in network operations expense which was further reduced by the drop in wholesale lines in service for the three and nine months ended September 30, 2005 as compared to the same periods in 2004.

**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 break-down by segment of sales and marketing expense:

Sales & marketing expense by segment (in millions)	For the three months ended September 30,		Percentage of Segment Revenues	
	2005	2004	2005	2004
Retail Segment	\$ 2.6	\$ 4.8	7.6%	11.5%
Wholesale segment		0.0	0.0%	0.2%
Total Sales & Marketing Expense	\$ 2.6	\$ 4.8	5.9%	7.9%

Sales & marketing expense by segment (in millions)	For the nine months ended September 30,		Percentage of Segment Revenues	
	2005	2004	2005	2004
Retail Segment	\$ 11.5	\$ 14.6	9.7%	11.3%
Wholesale segment		0.2	0.0%	0.3%
Total Sales & Marketing Expense	\$ 11.5	\$ 14.8	7.6%	7.7%

*Retail Segment*

The decrease in sales and marketing expense during the three months and nine months ended September 30, 2005 as compared to the same periods in 2004 was primarily due to commissions paid to independent sales representatives. A portion of the commission payments is directly related to the number of new lines brought in by the sales representatives. Since line counts have decreased, the corresponding commission payments have decreased as well.

*Wholesale Segment*

We are not actively seeking any new wholesale relationships at this time, therefore we are not currently expending any effort in this regard.

**Table of Contents****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 break-down by segment of general and administrative expense:

General & administrative expense by segment (in millions)	For the three months ended September 30,		Percentage of Segment Revenues	
	2005	2004	2005	2004
Retail Segment	\$ 15.6	\$ 21.1	45.9%	51.1%
Wholesale segment	1.4	6.1	13.9%	31.1%
Total General & Administrative Expense	\$ 17.0	\$ 27.2	38.6%	44.6%

General & administrative expense by segment (in millions)	For the nine months ended September 30,		Percentage of Segment Revenues	
	2005	2004	2005	2004
Retail Segment	\$ 52.4	\$ 72.3	44.3%	55.9%
Wholesale segment	5.7	20.0	16.9%	31.3%
Total General & Administrative Expense	\$ 58.1	\$ 92.3	38.2%	47.8%

The decrease in general and administrative expenses during the three and nine months ended September 30, 2005 as compared to the same periods in 2004 is explained by decreases in payroll and payroll related expenses, contract development, legal expenses, billing, collections, professional and consulting fees and ILEC setup fees to establish service for new customers. These decreases were slightly offset by increases in bad debt expense and ILEC performance credits.

We have improved our operating costs and overall operations, which has contributed to improved per line administrative cost factors. We anticipate general and administrative expenditures will decrease in total as management continues to rationalize operating costs. However, this will be offset to some extent by our expected increase in VoIP during 2006. 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. We expect to see continued improvements to the reductions of general and administrative expense as a percentage of total reported revenue in 2005 relative to 2004.

**Retail Segment**

General and administrative expense decreased \$5.5 million and \$19.9 million for the three and nine months ended September 30, 2005, respectively, as compared to the same periods in the prior year. The largest decreases occurred in payroll and payroll related expenses, legal expenses, billing expenses and contract development expenses.

These decreases were slightly offset by an increase in ILEC performance credits for failure to meet certain service levels and an increase in bad debt expense due to the \$2.5 million reserve that we booked against the SipStorm note, as mentioned in footnote 9 in the Notes to Consolidated Financial Statements Related Party Transactions.

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 decrease in general and administrative expense for the three and nine months ended September 30, 2005 as compared to the same periods in 2004 is a direct result of decreased wholesale lines in service. The expense line items that decreased most significantly are payroll and payroll related expenses, billing expenses, outsourced collection expenses and ILEC setup fees to establish service for new customers.

We expect to steadily decrease headcount related to supporting the subscriber lines of our existing wholesale customers. We have not recorded any bad debt expense for our wholesale services and have not had any material write-offs of receivables. We will continue to monitor our wholesale services and determine the appropriate bad debt methodology based on each individual wholesale contract, but we do not expect any material changes to our current approach.

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### **Depreciation and Amortization**

Depreciation and amortization expense decreased \$2.6 million and \$5.9 million for the three and nine months ended September 30, 2005, respectively, as compared to the same periods in the prior year. The decrease was the result of decreased capital spending, asset disposals and an increase in the number of assets which became fully depreciated during the later part of 2004 and the first nine months of 2005.

### **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 nine months ended September 30, 2005, interest and other income also includes \$6 million of lawsuit proceeds from our settlement with SBC Communications, Inc. and several of its subsidiaries, as described in the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2004.

### **Interest and Other Expense**

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

The increase in interest and other expense during the three and nine months ended September 30, 2005 as compared to the same periods in 2004 was primarily attributable to the discount fees paid to Thermo, increase in balance of standby credit facility and increase in late fees for vendor payments during 2005.

### **Net Loss Attributable to Common Stockholders**

Net loss attributable to common stockholders decreased by \$11.1 million and \$37.8 million during the three and nine months ended September 30, 2005, respectively, as compared to the same periods in 2004. In addition to the decreases in our operating losses and the income from the legal settlement discussed above, an additional \$5.3 million and \$13.4 million for the three and nine months, respectively, was attributable to the preferred stock conversion that occurred at the end of 2004.

## **LIQUIDITY AND CAPITAL RESOURCES**

The accompanying unaudited 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 on, among other things, the company's ability to operate profitably, to generate cash flow from operations and to obtain funding adequate to fund its business.

We have a limited operating history and our operations are subject to material 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 September 30, 2005, we had an accumulated deficit of approximately \$417.3 million and \$0.2 million in cash and cash equivalents. We have funded our expenditures primarily through operating revenues, private securities offerings, various working capital facilities, our standby credit facility and an initial public offering.

The company's inability to operate profitably and to consistently generate cash flows from operations, its reliance therefore on external funding either from loans or equity raise substantial doubt about the company's ability to continue as a going concern.

For the nine months ended September 30, 2005, net cash used in operating activities was \$2.1 million as compared to \$15.2 million in the prior year period.

In April 2004, the company secured an asset based loan facility with Textron Financial Corporation (Textron), which provided up to \$25 million to fund operations. Effective January 27, 2005, we entered into a Modification and Termination Agreement with Textron. Among other things the Modification and Termination Agreement provided

that Textron would forbear from exercising default rights and remedies until May 31, 2005, would waive the early termination fee and modify the annual facility fee. We agreed to pay a modification fee of \$150,000.

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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. On May 6, 2005, we used proceeds from this accounts receivable financing facility to pay off our loan balance with Textron.

By letter dated May 6, 2005, the Nasdaq Stock Market notified us that the market value of our common stock remained below the minimum of \$35 million required by Marketplace Rule 4310(c)(2)(B)(ii) and accordingly our shares would be delisted from the Nasdaq SmallCap Market at the opening of business on May 17, 2005. We appealed the decision and presented a definitive plan for regaining compliance to a hearing panel. A Nasdaq Listing Qualifications Hearing Panel granted the company a temporary exception from these requirements subject to the following conditions:

(1) The company's Form 10-Q for the quarter ended June 30, 2005 must evidence pro forma stockholders' equity of at least \$2,500,000 at June 30, 2005.

(2) The company's Form 10-Q for the quarter ended September 30, 2005 must report actual stockholders' equity at September 30, 2005 of at least \$2,500,000.

(3) On or before September 30, 2005, the company must evidence a closing bid price of at least \$1.00 per share and immediately thereafter a closing bid price of at least \$1.00 per share for a minimum of 10 consecutive trading days. While we satisfied conditions (1) and (3), our stockholders' equity as of September 30, 2005 as indicated by this report was less than \$2,500,000. Accordingly, we may be delisted from the NASDAQ SmallCap Market. This report will serve as notice to the NASDAQ Stock Market, Inc. of our material noncompliance with NASDAQ's rules for continued listing on the NASDAQ SmallCap Market. In that event we expect our shares will begin trading on the OTC Bulletin Board.

On September 23, 2005, our shareholders approved a one-for-ten reverse stock split of our common stock. The reverse stock split was affected on September 26, 2005. Fractional shares were not issued in connection with the reverse stock split. All share and per share amounts have been restated herein to reflect the one-for-ten reverse stock split.

Effective September 30, 2005, our chief operating officer, Frank Grillo has resigned to pursue other opportunities. No replacement chief operating officer has been appointed. Instead our chief executive officer, Horace J. Trey Davis, III, will take over Mr. Grillo's duties.

Our net cash used in investing activities decreased by \$4.0 million to \$2.2 million for the nine months ended September 30, 2005, compared to \$6.2 million the prior year period. The reduction was attributable to the purchasing of less property and equipment during the nine months ended September 30, 2005 as compared to the same period in the prior year.

For the nine months ended September 30, 2005, net cash provided by financing activities was \$3.1 million as compared to \$14.2 million for the prior year period. This change is primarily the result of using proceeds from our accounts receivable financing facility to payoff our asset based loan with Textron.

## **DEBT INSTRUMENTS**

### **Working Capital Financing**

On April 4, 2005, we entered into an accounts receivable financing agreement with Thermo Credit, LLC ( Thermo ) to replace our Textron credit facility. 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. The discount rate is 2.5%.

Purchase of the receivables is at the option of Thermo. On May 6, 2005, we used proceeds from this accounts receivable financing facility to pay off our loan balance with Textron.

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 is increased from 2.5% to 2.75%.

## **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 September 30, 2005 are summarized in the following table:



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	Outstanding Disputes at September 30, 2005 (in millions)
Alternatively billed services	\$ 6.0
Late fees for non-payment of disputed charges	5.8
Billing errors	4.8
All others	1.8
	\$ 18.4

Alternatively billed services are primarily charges for certain 1-800, collect and information service calls. These disputes are largely historic in nature. We settled certain of these disputes in Texas with Southwestern Bell Telephone Company. 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 \$18.4 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.

**RELATED PARTY TRANSACTIONS**

On September 29, 2004, we signed an agreement with SipStorm, Inc., a company owned by two of our shareholders and former officers of our company; we transferred selected computer hardware, software and intellectual property rights to SipStorm. Relative to the purchase, SipStorm assumed responsibility for certain accounts payable, future maintenance payments and provided a promissory note in the amount of \$2.8 million. The promissory note was settled for \$250,000 during the second quarter of 2005. The note was collateralized by shares of our common stock owned by the directors of SipStorm and \$250,000 reflected the estimated realizable value of that portion of our common stock at the time of the settlement.

**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 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 Acting Chief Financial Officer, J. Michael Morgan, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, Messrs. Davis and Morgan have concluded that our disclosure controls and procedures are effective in causing material information to be recorded, processed, summarized, and reported so as to ensure the quality and timeliness of our public disclosures in compliance with SEC rules and forms.

**Changes in Internal Control over Financial Reporting**

We also maintain a system of internal control over financial reporting. Our internal control over financial reporting is a process designed under the supervision of our chief executive officer and our chief financial officer and effected by our board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles and includes those policies and procedures that (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets and (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors. 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.

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**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 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. We believe we are entitled to indemnification from our Underwriters.

A settlement has been reached by the respective lawyers for 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. The court has given preliminary approval of the settlement subject to certain modifications. A revised settlement agreement has been submitted to the court. To be binding, the settlement must be executed by the parties and thereafter submitted to and approved by the court. The settlement will not be binding upon any plaintiffs electing to opt-out of the settlement.

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 class action lawsuit against Trinsic Communications, Inc. (formerly known as Z-Tel Communications, Inc.), our wholly-owned subsidiary corporation, on May 13, 2004. The lawsuit alleges that our subsidiary has 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 complaint seeks 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 complaint asserts a claim under the Illinois Consumer Fraud and Deceptive Business Practices Act and seeks 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 within 28 days) 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. While the partial dismissal with prejudice is a positive development, and although we believe the plaintiff's allegations are without merit and intend to defend the lawsuit vigorously, we cannot predict the outcome of this litigation with any certainty.

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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 \$[ ]. 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

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 expect to resolve this dispute

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

At the Annual Meeting of Shareholders held on July 1, 2005, the following proposal was adopted by the margins indicated:

1. To elect the following individuals to the Board of Directors to hold office until their successors are elected and qualified:

Nominee	Number of Shares	
	For	Withheld
Andrew C. Cowen	42,725,167	54,374
Raymond L. Golden	42,724,352	55,189

The terms of office of the following other directors continued after the meeting:

W. Andrew Krusen  
Lawrence C. Tucker  
Richard F. LaRoche, Jr.  
Roy Neel

On September 23, 2005, we held a special meeting of the stockholders at which the following proposals were approved:

- I. To permit the conversion (the Conversion ) of Trinsic s approximately \$24.1 million aggregate liquidation preference of Series H Preferred Stock into common stock at a conversion price equal to \$0.39, per share, subject to antidilution adjustments; provided, however, that if on or prior to September 29, 2005, Trinsic shall not have entered into a definitive agreement(s) to acquire no less than 150,000 UNE-P subscriber lines (tested as of September 29, 2005), then the permitted conversion price shall reduce to \$0.20 per share, subject to antidilution adjustments; and
- II. To approve an amendment of Trinsic s certificate of incorporation to effect a reverse stock split of the common stock in the ratio of an integral number between and including three and twelve to one, as determined at the discretion of the board of directors, which reverse stock split at any ratio may be abandoned at any time prior to effectiveness at the discretion of the board of directors, notwithstanding Stockholders authorization thereof.

The proposals are more fully described in our definitive proxy statement filed with the Securities and Exchange Commission on September 2, 2005.

The votes cast for and against each proposal are set forth below.

Proposal I

For

Against

Abstention

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Proposal II	34,946,454	890,643	78,391
	For 34,926,806	Against 977,194 26	Abstention 11,488

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**ITEM 6. EXHIBITS**

**(a) The following exhibits are filed as part of this report:**

<b>EXHIBIT NUMBER</b>	<b>DESCRIPTION</b>
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.
4.6	Form of Warrant for the purchase of shares of our common stock by each of the purchasers of our Series D Convertible Preferred Stock. Incorporated by reference to the correspondingly numbered exhibit to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, filed on August 14, 2000.
4.7	Stock and Warrant Purchase Agreement, dated October 19, 2000, by 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.
4.9	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.
4.10	Warrant issued to The 1818 Fund III, L.P. for the purchase of shares of our common stock. 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



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<b>EXHIBIT NUMBER</b>	<b>DESCRIPTION</b>
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 filed July 12, 2001 with respect to our common stock by, among other persons, The 1818 Fund III, L.P.
4.16	Warrant for the Purchase of Shares of Common Stock of Trinsic, dated as of July 2, 2001. Incorporated by reference to Exhibit 2 to Amendment No. 1 of the Schedule 13D filed July 12, 2001 with respect to our common stock by, among other persons, The 1818 Fund III, L.P.
4.17	Backup Purchase Agreement, dated as of July 2, 2001, by and among Z-Tel Communications, Inc., a Delaware corporation and our wholly owned subsidiary, Touch 1 Communications, Inc., an Alabama corporation and our wholly owned subsidiary, D. Gregory Smith and others. Incorporated by reference to Exhibit 4 to Amendment No. 1 of the Schedule 13D filed July 12, 2001 with respect to our common stock by, among other persons, The 1818 Fund III, L.P.
4.18	Additional Investor Registration Rights Agreement, dated as of July 2, 2001, between Z-Tel, D. Gregory Smith and others. Incorporated by reference to Exhibit 5 to the Schedule 13D filed July 24, 2001 with respect to our common stock by, among other persons, D. Gregory Smith.
4.19	Voting Agreement, dated as of June 29, 2001, between us and certain of our stockholders. Incorporated by reference to Exhibit 5 to Amendment No. 1 of the Schedule 13D 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.
4.21	Certificate of Designation of Convertible Preferred Stock, Series H. Incorporated by reference to Exhibit B to our Form 8-K filed July 20, 2005.
4.22	Voting Agreement, dated August 31, 2005, between us and The 1818 Fund III, L.P. Incorporated by reference to Exhibit B to our Form 8-K filed September 7, 2005.
10.1.1	Standby Credit Facility Agreement, dated August 24, 2004, by and among Trinsic, Inc. and The 1818 Fund III, L.P. Incorporated by reference to Form 8-K filed on August 26, 2004
10.1.2	Amendment No. 1, dated May 24, 2005, to Standby Credit Facility Agreement, dated August 24, 2004 by and between Trinsic, Inc. and The 1818 Fund III, L.P.
10.1.3	Amended and Restated Senior Unsecured Promissory Note dated August 24, 2004 from Trinsic, Inc. to The 1818 Fund III, L.P.
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

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and as effective December 14, 1999.

- 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 Loan and Security Agreement, dated April 22, 2004, by and between Textron Financial Corporation and Z-Tel. Incorporated by reference to Exhibit 10.2 of our Registration Statement on Form S-3 (File No. 333-116747), originally filed June 22, 2004, as amended and as effective July 15, 2004.
- 10.4 Receivables Sales Agreement dated as of July 27, 2000 by and between Z-Tel Communications, Inc., as seller and subservicer, Touch 1 Communications, Inc., as seller and subservicer, and RFC Capital Corporation, as purchaser. Incorporated by reference to the correspondingly numbered exhibit to our Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, filed on August 14, 2000, with an amendment extending the agreement until July 27, 2004.

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<b>EXHIBIT NUMBER</b>	<b>DESCRIPTION</b>
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 Horace J. Trey Davis III, dated August 14, 2002. Incorporated by reference to the correspondingly numbered exhibit to our Quarterly Report on Form 10-Q for the quarter ended March 31, 2004, filed on May 17, 2004. By amendment dated October 5, 2004, the annual salary was increased to \$300,000. The amendment is incorporated by reference to Exhibit 99.1 to Form 8-K filed October 12, 2004.
10.7	Modification and Termination Agreement dated January 27, 2005 with Textron Financial Corporation modifying our Loan and Security Agreement dated April 22, 2004. Incorporated by reference to Exhibit 10.4 to Form 8-K filed February 2, 2005.
10.8	Asset Sale and Purchase Agreement dated September 29, 2004, between and among Sipstorm, Inc. and us. Incorporated by reference to Exhibit 99.1 to October 6, 2004.
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.
10.12	Promissory Note, dated September 10, 1999, from Touch 1 Communications, Inc. to James F. Corman. 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.
10.13	Agreement for Resale of Local Wireline Telecommunications Services and Provision of Ancillary Services, dated February 4, 2003, between Z-Tel Communications Inc. and Sprint Communications L.P. Incorporated by reference to Exhibit 10.14 of our Annual Report on Form 10-K for the year ended December 31, 2003, filed March 30, 2004. Portions of this exhibit have been omitted pursuant to a request for confidential treatment
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 i April 5, 2005.
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 14th day of November 2005.

**TRINSIC, INC.**

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

Horace J. Davis, III  
Chief Executive Officer

By: */s/ J. MICHAEL MORGAN*

J. Michael Morgan  
Acting 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.