LARKIN C RAYMOND JR
Form 4
November 01, 2017

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number: 3235-0287
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(Print or Type Responses)

1. Name and Address of Reporting Person *
LARKIN C RAYMOND JR

(Last) (First) (Middle)

C/O ALIGN TECHNOLOGY, INC., 2560 ORCHARD PARKWAY

(Street)

SAN JOSE, CA 95131

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
ALIGN TECHNOLOGY INC [ALGN]

3. Date of Earliest Transaction (Month/Day/Year)
10/31/2017

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director
_____ 10% Owner
_____ Officer (give title below)
_____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	05/17/2017		G		214	D	$ 0	83,348	D	
Common Stock	07/06/2017		G		40	D	$ 0	83,308	D	
Common Stock	09/20/2017		G		27	D	$ 0	83,281	D	
Common Stock	09/25/2017		G		27	D	$ 0	83,281	D	
Common Stock	10/12/2017		G		53	D	$ 0	83,201	D	

Common Stock	10/31/2017	10/31/2017	M	15,000	A	$ 20.79	98,201	D
Common Stock	10/31/2017	10/31/2017	S	15,000	D	$ 238.82 (1)	83,201	D

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)	
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares
Right to Buy (Common Stock)	$ 2.079	10/31/2017	10/31/2017	M			15,000	02/18/2012	02/18/2018	Common Stock	15,000

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
LARKIN C RAYMOND JR C/O ALIGN TECHNOLOGY, INC. 2560 ORCHARD PARKWAY SAN JOSE, CA 95131	X			

Signatures

Roger E. George Atty-in-Fact for Raymond Larkin	11/01/2017
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) The price reported in column 4 is a weighted average price. These shares were sold in multiple transactions at prices ranging from $237.70 to $239.40, inclusive. The reporting person undertakes to provide Align Technology, Inc., any security holder of Align Technology, Inc. or the staff of the Securities and Exchange Commission, upon request, full information regarding the number of shares sold at each separate price within the range set forth in this footnote.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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Finance charges are assessed to accounts once the amount owed is past due based on their specific terms. The allowance for doubtful accounts is estimated by management and is based on specific information about customer accounts, past loss experience, and general economic conditions. An account is written off by management when deemed uncollectible, although collections efforts may continue.

Property and Equipment: Property and equipment are stated at cost. Major additions and improvements are capitalized, while minor repairs and maintenance costs are expensed when incurred. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets as follows:

Computer equipment	3 years
Computer software	2 to 3 years
Internal-use software	3 years
Furniture and fixtures	3 to 7 years
Leasehold improvements	Shorter of useful life or remainder of lease term

Capitalized Software Costs: In accordance with Statement of Position 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use,* the Company capitalizes certain costs incurred for the development of internal use software. These costs include the costs associated with coding, software configuration, upgrades, and enhancements. During 2006, 2005, and 2004 the Company capitalized approximately $569,000, $131,000 and $677,000, respectively.

Intangible Assets: Intangible assets consist of customer lists, patents, technology, and licenses. Customer lists, with the exception of the Transtel customer base, are amortized on a straight-line basis over 36 to 48 months. The customer base acquired with the Transtel acquisition is amortized using an accelerated method over 48 months. Patents, technology, and licenses are amortized on a straight-line basis over their estimated useful life of four years. UCN performs an annual evaluation of the recoverability of the carrying value of our intangible assets using undiscounted cash flow projections net of

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related commissions and estimated costs of revenue. UCN also monitors other possible triggering events that could cause impairment and performs an evaluation of impairment at that time if deemed necessary. Based upon our cash flow projections the intangible assets were not impaired at December 31, 2006 and 2005.

Long-Lived Assets: In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we evaluate the carrying value of long-lived assets, including intangibles, when events or circumstances indicate the existence of a possible impairment, based on projected undiscounted cash flows, and recognize impairment when such cash flows will be less than the carrying values. Measurement of the amounts of impairments, if any, is based upon the difference between carrying value and fair value. Events or circumstances that could indicate the existence of a possible impairment include obsolescence of the technology, an absence of market demand for the product, and/or continuing technology rights protection. Management believes the net carrying amount of long-lived assets will be recovered by future cash flows generated by commercialization of the technology related to the long-lived asset, and from cash flows generated from customer lists. UCN did not record impairment charges in relation to long-lived assets during 2006 or 2005.

Off-balance Sheet Arrangements There are no off-balance sheet arrangements.

Advertising Costs: The Company advertises its services through traditional venues such as print media to the general public. Costs associated with these advertising efforts are expensed as incurred, and were approximately $350,000, $31,000 and $14,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

Debt Issuance Costs: Debt issuance costs are amortized over the life of the respective debt instrument using the interest method. At December 31, 2006 and 2005, there were $144,000 and $379,000, respectively, of unamortized debt issuances costs.

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

SFAS 123(R) requires companies to estimate the fair value of stock-based awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statements of Operations. UCN adopted SFAS 123(R) using the modified prospective transition method which requires the application of the accounting standard starting from January 1, 2006. The Consolidated Financial Statements, for the year ended December 31, 2006, reflect the impact of SFAS 123(R).

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

Stock-based compensation expense recognized during a period is based on the value of the portion of stock-based awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the year ended December 31, 2006, included compensation expense for stock-based awards granted prior to, but not yet vested as of December 31, 2005, based on the fair value on the grant date estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for the stock-based awards granted subsequent to December 31, 2005, based on the fair value on the grant date estimated in accordance with the provisions of SFAS 123(R). As stock-based compensation expense recognized in the results for the year are based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Prior to 2006, UCN accounted for forfeitures as they occurred for the purposes of pro forma information under SFAS 123, as disclosed in our notes to Consolidated Financial Statements for the related periods.

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

Additional information on stock-based compensation can be found in Note 13.

Business Segments: SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information,* establishes standards for the way public business enterprises are to report information about operating segments in annual financial statements and requires enterprises to report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosure about products and services, geographic areas and major customers. UCN has continued to focus marketing efforts towards providing on-demand contact center software and specialized telecommunications services, in addition to traditional long distance services. Additional information on segments can be found in Note 17.

Income Taxes: The Company recognizes a liability or asset for the deferred income tax consequences of all temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements that will result in taxable or deductible amounts in future years when the reported amounts of the assets and liabilities are recovered or settled. These deferred income tax assets or liabilities are measured using the enacted tax rates that will be in effect when the differences are expected to reverse. Recognition of deferred tax assets is limited to amounts considered by management to be more likely than not of realization in future periods.

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

Recent Accounting Pronouncements

Prior Year Misstatements - In September 2006, the SEC released Staff Accounting Bulletin (SAB) 108, which is codified as SAB Topic 1.N, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, providing interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. Based on this guidance, the SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach (dual method approach)and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. The adoption of SAB 108, effective December 31, 2006, did not have a material effect on the consolidated financial statements.

Uncertainty in Income Taxes - In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which prescribes a recognition threshold and a measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006, which is our first quarter of 2007. The adoption of FIN 48 is not expected to have a material impact on the Company s financial condition and results of operations.

Fair Value Measurements - In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*. SFAS 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on assumptions that market participants would use in pricing the asset or liability. The Company is required to adopt SFAS 157 in the first quarter of 2008. The Company does not expect that the implementation of SFAS 157 will have a material effect on the Company s results of operations or financial position.

Fair Value Option - In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Liabilities Including an amendment of FASB Statement No. 115.* SFAS 159 permits entities to choose to measure certain

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financial assets and liabilities at fair value (the fair value option). Unrealized gains and losses, arising subsequent to adoption, are reported in earnings. The Company is required to adopt SFAS 159 in the first quarter of 2008. The Company does not expect that the implementation SFAS 159 will have a material effect on the Company s results of operations or financial position.

NOTE 2 ACQUISITIONS

Transtel Communications, Inc.

On May 1, 2005 UCN entered into an agreement with Telephone Electronics Corporation (TEC), and with Transtel Communications, Inc., a subsidiary of TEC, wherein UCN agreed to purchase all of the operating assets and certain of the liabilities of Transtel and its subsidiaries. For UCN, the acquisition provided: 1) access to valuable assets without dilution to equity shareholders, 2) 20,000 customers, 3) immediate access to additional network infrastructure, and 4) additional sales and customer support professionals. UCN issued to Transtel an eight percent promissory note for the purchase price of $2.1 million, after imputing additional interest. The note is was satisfied if full at the closing of the ComVest agreement in May 2006. At the time of the acquisition, UCN anticipated incurring additional acquisition costs of approximately $2.7 million. Such costs included $1.5 million of involuntary employee termination expenses, and carrier switchover and other shut-down costs, and included $1.2 million related to the present value of assumed operating leases which will not be utilized by the Company, net of estimated sublease rentals (see also Note 9).

During 2005 since the acquisition date, the Company obtained additional information in order to finalize the purchase price allocation with respect to a covenant not to compete and additional switchover costs, and was able to determine the actual acquisition costs. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

Current assets	$ 2,420
Property, plant and equipment	208
Intangible assets, including customer base (Note 4)	4,166
Other assets	255
Total assets acquired	7,049
Current liabilities	(4,266)
Other long-term liabilities	(661)
Total liabilities assumed	(4,927)
Net assets acquired	$ 2,122

MyACD, Inc.

In October 2003, UCN acquired the exclusive right to sell and manage the enhanced telecommunications technology of MyACD, Inc., with a one-year option to purchase MyACD. MyACD developed a telephony software solution for call center traffic management and related functions that UCN can now offer to its customers over its network. In September 2004 the Company entered into agreements that finalized payment terms, and set a date for closing the transaction. On January 5, 2005, UCN closed the acquisition and purchased all of the outstanding capital stock of MyACD, which provides the Company with the technology to provide its customers the inContact solution.

The Company issued $4.3 million of promissory notes, after imputing interest, cash of $427,000 and 562,985 shares of UCN common to acquire all the outstanding stock of MyACD. The fair market value of the common stock on the date the parties set the price was $2.28 per share. The notes were satisfied if full at the closing of the ComVest agreement in May 2006. In connection with the acquisition, UCN also incurred transaction liabilities of approximately $19,000 and assumed certain liabilities aggregating approximately $358,000. The Company also recorded a deferred tax liability of approximately $302,000 at the time of the purchase. The capitalized cost of $6.7 million was assigned to what management considers is MyACD s sole asset, its software technology, which management determined to have an estimated useful life of four years. The following table summarizes the assets acquired, liabilities assumed, and obligations incurred in the acquisition:

Fair value of acquired technology (Note 4)	$ 6,662
Liabilities assumed and incurred	(377)
Deferred tax liability	(302)
Net assets acquired	$ 5,983
Promissory notes issued to MyACD, Inc. stockholders	$ 4,272
UCN, Inc. stock issued	1,284
Cash paid	427
Consideration given	$ 5,983

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The Company has accounted for both the MyACD and Transtel transactions using the purchase method of accounting, and has included the operating results of each acquisition in UCN s statements of operations since the respective date of each acquisition.

Other

UCN entered into an agreement to purchase 37 dedicated long distance customers from Source Communications, LLC for $750,000 in February 2004 (Note 4). Closing of the acquisition was subject to complying with applicable federal and state regulation pertaining to transfer of the customers. All of the regulatory requirements were satisfied and the acquisition of the customers was completed during the summer of 2004.

During August 2003, UCN purchased approximately 12,000 long distance customers from Glyphics Communications, Inc. for $544,000. Subsequently, the two parties agreed that UCN would accelerate payments under the agreement in exchange for a discount on the purchase price. The final payment under the agreement was made in February 2004, and the Company recorded a $109,000 gain on the early extinguishment of the debt.

NOTE 3 PROPERTY AND EQUIPMENT

Property and equipment consisted of the following (in thousands):

	December 31, 2006	December 31, 2005
Computer and office equipment	$ 5,828	$ 5,048
Computer software	2,814	2,416
Internally developed software	1,640	1,077
Furniture and fixtures	418	376
	10,700	8,917
Accumulated depreciation	(5,890)	(3,692)
	$ 4,810	$ 5,225

Total depreciation expense for the years ended December 31, 2006, 2005, and 2004 was $2.3 million, $2.1 million, and $1.4 million, respectively.

NOTE 4 INTANGIBLE ASSETS

Intangible assets consisted of the following (in thousands):

	December 31, 2006			December 31, 2005		
	Gross Assets	Accumulated Amortization	Intangible assets, net	Gross Assets	Accumulated Amortization	Intangible assets, net
Customer lists acquired	$ 15,684	$ 12,777	$ 2,907	$ 15,684	$ 9,677	$ 6,007
Technology and patents	7,980	4,540	3,440	7,980	2,545	5,435
Non-compete agreement	154	128	26	154	51	103
	$ 23,818	$ 17,445	$ 6,373	$ 23,818	$ 12,273	$ 11,545

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On May 1, 2005, UCN recorded $4.2 million related to an acquired customer list of Transtel Communications, Inc. (Note 2). The customer base is expected to have an estimate useful life of four years and is amortized using an accelerated method.

During the first quarter of fiscal 2005, UCN recorded an additional $6.7 million of acquired software technology in connection with closing the acquisition of MyACD. The technology is believed to have an estimated useful life of four years and is amortized using the straight-line method.

Customer lists acquired increased by $750,000 during 2004 when UCN entered into an agreement to purchase dedicated long distance customers from Source Communications, LLC (Note 2). These lists are amortized over the expected life of the relationship with the customers.

Total amortization expense of intangible assets for the years ended December 31, 2005, 2004, and 2003 was $5.2 million, $5.2 million, and $2.9 million, respectively. The Company estimates the useful lives of its acquired customer lists based on estimated attrition rates using estimated useful lives for acquired customer lists to range from 36 to 48 months.

Based on the recorded intangibles at December 31, 2006, all intangibles will be amortized in three years. Estimated amortization expense over the next three years is expected to be approximately $3.4 million, $2.6 million and $313,000, respectively. This does not include amounts to be recorded in conjunction with the 2007 acquisitions discussed in Note 18.

NOTE 5 LINE OF CREDIT

During 2006 and 2005, UCN had a line of credit agreement with a financing company that was replaced by the ComVest agreement completed in May 2006 (Note 7). The previous line of credit had a maximum borrowing amount of $10 million and a variable interest rate equal to Citibank s announced base rate plus 2.25%, but in no event less than 9.25%. The rate at December 31, 2005 was 9.41%. Under the provisions of the line of credit, UCN was required to maintain a restricted cash account for the collection of receivables. The restricted cash account was used to pay down the amount outstanding and was replenished with ongoing collections from customers. UCN had $651,000 of restricted cash associated with the line of credit arrangement at December 31, 2005. The agreement also required the Company to maintain a minimum operating cash balance of $1.5 million.

NOTE 6 ACCRUED LIABILITIES

Accrued liabilities consisted of the following (in thousands):

	December 31, 2006	December 31, 2005
Accrued payphone and carrier charges	$ 782	$ 660
Accrued payroll and other compensation	656	633
Current portion of operating lease obligations (Note 9)	250	436
Accrued professional fees	164	90
Assumed acquisition liabilities		158
Other	172	291
	$ 2,024	$ 2,268

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NOTE 7 LONG-TERM DEBT AND NOTES PAYABLE

Long-term debt consists of the following (in thousands):

	December 31, 2006	December 31, 2005
Convertible term note to ComVest Capital, LLC of $4.5 million, bearing interest at a fixed 9.0 percent payable on a monthly basis, there are no principal payments due through November 2007 afterwhich the loan requires monthly principal payments of $125,000 with any unpaid amounts due on May 2010, outstanding principal amount is convertible to common stock at $3.00 per share	$ 3,380	$
Revolving credit note with ComVest Capital, LLC, with maximum availability of $7.5 million, bearing interest at a fixed 9.0 percent payable on a monthly basis, there are no requirements to repay outstanding principal payments until May 2010	3,258	
Capital Leases (Note 10)	1,042	2,363
Unsecured note payable to the Chairman of the Board, bearing interest at 12 percent payable monthly. Paid in full in 2006.		75
Unsecured note payable to a former Director, bearing interest at 12 percent, payable monthly, due January 2006, and convertible to common stock at $2.00 per share. Paid in full in 2006.		250
Promissory notes payable to two former MyACD stockholders, interest imputed at 8.25 percent. Paid in full in 2006.		3,713
Promissory note payable to a former MyACD stockholder, interest imputed at 8.25 percent, payable monthly. Paid in full in 2006.		249
Promissory note payable to Transtel Communications, Inc. and subsidiaries bearing interest at 8 percent, principal and interest payable monthly. Paid in full in 2006.		1,827
	7,680	8,477
Current portion of long-term debt, net of debt discounts of $166	(84)	(2,066)
Current portion of capital lease payments (Note 10)	(636)	(900)
Debt discounts on convertible term note and revolving credit note	(437)	
	$ 6,523	$ 5,511

Long-term debt maturities, excluding capital lease payments included in Note 10, are as follows as of December 31, 2006:

Year ending December 31,	
2007	$ 250
2008	1,500
2009	1,500
2010	3,388
Total	$ 6,638

On May 23, 2006, UCN entered into the Revolving Credit Note and Term Loan Agreement with ComVest Capital, LLC, which included a $4.5 million convertible term note and a $7.5 million revolving credit note. These notes are secured by essentially all assets of the Company. As part of the agreement, UCN issued five-year detachable warrants to purchase 330,000 shares of common stock at $2.75 per share. UCN allocated $542,000 of the proceeds from the offering to the warrants based on the relative fair value of the warrants using the Black-Scholes pricing model in relation to the fair value of the convertible term note and revolving credit note using a discount cash-flows method.

UCN recognized a net loss on early extinguishment of debt of $364,000 in conjunction with completing the ComVest financing. Lower payoff amounts were negotiated with certain debt holders that resulted in gains from early extinguishment of debt of: 1) $205,000 from the Transtel acquisition (Note 2); 2) $120,000 from terminating the lease on UCN s billing software; and 3) $22,000 related to the note with a former MyACD shareholder. These gains was offset by: 1) $334,000 write-off of deferred debt financing fees; 2) $300,000 early termination fee paid to the holder of the previous line of credit; and 3) $77,000 difference in the book basis due to imputed interest on notes issued to former shareholders of MyACD.

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As amended in 2007 and effective for the period ended December 31, 2006, the term loan and revolving credit facility imposes certain financial covenants, including: 1) varying quarterly EBITDA targets (a non-GAAP measure that was specifically defined in the agreement); 2) an annual limit on capital expenditures of $3.2 million for all years beginning 2007, which includes a cap of $1.2 million in capitalized software costs and $2.0 million of all other capital expenditures and payments under newly acquired capital leases; and 3) a requirement to maintain a combined minimum of $3.0 million of cash balance and availability under the revolving credit facility. In consideration for this amendment, UCN paid ComVest a cash fee of $35,000 and issued 55,000 warrants (Note 12).

Under the terms of the agreement prior to the 2007 amendment, UCN had a limit of $1.5 million to spend for capital expenditures during 2006. During 2006, UCN spent a total of $1.7 million, which is net of the amounts purchased under capital leases during 2006 less cash payments for these same leases during the year. The Company received a waiver from the lender of any default due to exceeding the capital spending limit for 2006. The Company was in compliance with all other financial and non-financial covenants at December 31, 2006.

As required by APB 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, UCN allocated total debt proceeds based on the respective fair value of the securities issued. The discount is amortized to interest expense using the interest method over the life of the note. Based on the allocation of proceeds under APB 14, UCN recorded a discount on the convertible term note and revolving credit note of $210,000 and $332,000, respectively, based on their relative fair values to each other and to the warrant. The discount related to the convertible note is amortized to interest expense using the interest method over the life of the note. The discount related to the revolving credit note is amortized to interest expense using the straight-line method over the life of the note. UCN recorded interest expense of $105,000 for December 31, 2006 in conjunction with this amortization.

The $4.5 million term loan matures in May 2010 and accrues interest at a fixed nine percent. In conjunction with private placement of common stock that closed during May 2006, UCN was required to repay $1.1 million of the outstanding ComVest note balance in June 2006. Under the original agreement, UCN was not required to make principal payments of $125,000 until May 2007. With the 2007 amendment, these principal payments were delayed until November 2007.

The revolving credit note matures in May 2010, accrues interest at a fixed nine percent and provides for maximum availability of $7.5 million based on a calculation of 85 percent of billed and 65 percent unbilled accounts receivable at the measurement date. UCN is required to make monthly interest payments and the entire outstanding balance is due at maturity. There were $2.2 million of unused commitments at December 31, 2006 under the revolving credit note.

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

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

On January 5, 2005, UCN closed the acquisition of MyACD, Inc. and purchased all of the outstanding capital stock of MyACD from two stockholders (Note 2). The purchase price paid to MyACD stockholders was made in part by issuing promissory notes which aggregated $4.3 million, after imputing interest at 8.25 percent. UCN paid off all outstanding indebtedness relating to the MyACD acquisition in conjunction with the 2006 ComVest agreement.

In connection with the acquisition of Transtel Communications, Inc., UCN issued to Transtel and subsidiaries a promissory note in the principal amount of $2.1 million (Note 2). The Company paid off all outstanding indebtedness relating to the Transtel acquisition in conjunction with the 2006 ComVest agreement.

NOTE 8 FAIR VALUE OF FIXED RATE DEBT

The following disclosure of the estimated fair value of the Company and its subsidiaries financial instruments is made in accordance with the requirements of SFAS No. 107, Disclosures about Fair Value of Financial Instruments. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2006 and 2005. Although management is not aware of any factors that would

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significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amounts presented herein.

The carrying amounts reported in the accompanying consolidated balance sheets for cash, receivables, and accounts payable approximate fair values because of the immediate or short-term maturities of these financial instruments. The estimated fair value of the Company s convertible term note and notes payable are computed using a discounted cash flow model using estimated market rates at December 31, 2006 and 2005 as follows:

	December 31, 2006		December 31, 2005	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Convertible term note	$ 3,380	$ 3,379	$ 5,789	$ 5,801
Promissory notes	$	$	$ 325	$ 325

For the 2006 balance, the fair value of the fixed rate obligations listed above is approximated using a rate of 10.9 percent determined by the spread between the incremental borrowing rate at the date of closing the ComVest transaction on the three-year treasury note with a constant maturity at closing and the spread using the same three-year treasury note at December 31, 2006. For the 2005 balances, the fair value of the fixed rate obligations listed above is approximated using the rate currently charged for borrowings under the Company s previous line of credit agreement.

The table above does not include a listing for the revolving credit facility because it is not practicable to estimate its fair value as the future cash flows for the revolving credit facility are not predictable and the entire outstanding balances, if any, matures in May 2010. UCN estimates the effective interest rate for the revolving credit facility to be 10.3 percent determined by the spread between the incremental borrowing rate at the date of closing the ComVest transaction on the three-year Treasury Note with a constant maturity at closing and the spread using the same three-year Treasury Note at December 31, 2006.

NOTE 9 OTHER LONG-TERM LIABILITIES

In connection with the acquisition of certain assets and liabilities from Transtel Communications, Inc. (Note 2), the Company assumed certain operating lease obligations for facilities it does not anticipate using. The Company included the present value of these obligations, net of estimated future sub-lease income, in other liabilities assumed as of the acquisition date. At December 31, 2006 and 2005, the Company owed approximately $292,000 and $683,000, respectively. These obligations will be satisfied $245,000, $45,000 and $2,000 during 2007, 2008 and 2009, respectively.

NOTE 10 LEASES

UCN leases executive office space in Bluffdale, Utah, a suburb of Salt Lake City. The offices consist of approximately 30,000 square feet and have a current monthly lease rate of $35,000. The lease for office space expires in November 2007, but the Company has an option to renew the lease for an additional three to five years. The Company is currently reviewing the available options to determine whether to renew the lease for an additional term or relocate to another location in the greater Salt Lake area. UCN leases approximately 14,339 square feet of space at 13751 S. Wadsworth Park Drive, Draper, Utah, at a current monthly cost of $11,000. The Company has sublet this space for the same monthly amount, and also agreed to extend the lease an additional six months through May 2008.

UCN also currently utilizes other leased properties obtained in its acquisition of Transtel Communications in 2005. We lease a total of approximately 25,000 square feet of office space in downtown Salt Lake City, Utah, at a monthly cost of approximately $23,000, of which approximately $3,000 is being paid under a month-to-month arrangement and the remainder under a lease agreement that expires in September 2009. We also lease office space and related equipment switching space in Los Angeles and San Francisco, California, as well as Denver, Colorado at a total monthly cost, net of a $6,000 sub lease related to the Los Angeles location, of approximately $17,000 under agreements that expire in July 2009.

During the third quarter 2005, the Company purchased a three year license and an upgraded version of its telecommunications billing software totaling $1.1 million. We accounted for this obligation as a capital lease and will provide capacity for: 1) increased number of telecommunications customers, 2) improved billing options and 3) improved customer service options. In conjunction with the ComVest agreement as discussed in Note 7 we paid all outstanding indebtedness relating to this software in May 2006.

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The following is a schedule of future minimum payments under capital leases as of December 31, 2006 (in thousands):

Year ending December 31,	Capital Leases
2007	$ 697
2008	404
2009	14
Total future minimum lease payments	1,115
Less amount representing interest	(73)
Total obligations under capital leases	1,042
Less current portion	(636)
Long-term capital lease obligations, net of current portion	$ 406

The following schedule shows the composition of total remaining commitments for operating leases at December 31, 2006 (in thousands):

Year ending December 31,	Gross Operating Leases	Less: Sub-lease Income	Net Operating Leases
2007	$ 1,037	$ 185	$ 852
2008	331	45	286
2009	182		182
Total	$ 1,550	$ 230	$ 1,320

Rent expense was approximately $857,000, $568,000, and $876,000 for the years ended December 31, 2006, 2005 and 2004, respectively. These amounts are net of sublease related income of $205,000 and $107,000 for the years ended December 31, 2006 and 2005, respectively.

NOTE 11 INCOME TAXES

The components of income tax expense (benefit) for the years ended December 31, 2006, 2005, and 2004, are as follows (in thousands):

	2006	2005	2004
Current expense:			
Federal	$ 2	$	$
State	12		
Total current expense	14		
Deferred benefit:			
Federal		(259)	
State		(43)	
Total deferred benefit		(302)	
Total	$ 14	$ (302)	$

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Income tax (benefit) expense differs from amounts computed by applying the statutory federal rate of 34.0 percent to pretax loss as of December 31, 2006, 2005, and 2004, as follows (in thousands):

	2006	2005	2004
Computed federal income tax benefit at statutory rate of 34%	$ (2,639)	$ (2,873)	$ (718)
State income taxes	6	(296)	(97)
Exercise of employee stock options			(125)
Meals and entertainment	19	32	19
Other	4	13	4
Stock-based compensation expense under FAS 123(R)	48		
Change in income tax valuation allowance	2,576	2,822	917
Total income tax (benefit) expense	$ 14	$ (302)	$

Deferred income tax assets and liabilities at December 31, 2006 and 2005, consisted of the following temporary differences and carry-forward items (in thousands):

	2006		2005	
	Current	Non-current	Current	Non-current
Deferred income tax assets:				
Net operating loss carry-forwards	$	$ 10,360	$	$ 9,009
AMT credit carry-forwards		69		
Book depreciation and amortization in excess of tax depreciation and amortization		2,983		1,334
Reserves, accrued liabilities, and other	826	71	677	
Stock-based compensation (FAS 123R)		163		
Total deferred income tax assets	826	13,646	677	10,343
Valuation allowance	(826)	(13,646)	(608)	(10,299)
Deferred income tax assets			69	44
Deferred income tax liabilities:				
MyACD stock acquisition			(69)	(44)
Net	$	$	$	$

SFAS No. 109, *Accounting for Income Taxes,* requires that a valuation allowance be established when it is more likely than not that all or a portion of a deferred tax asset will not be realized. The Company is uncertain whether its deferred tax assets can be realized due to its history of operating losses. Accordingly, a valuation allowance has been recorded to reduce the deferred income tax assets to the amount which management believes is more likely than not to be realized.

The net change in the Company s valuation allowance was an increase of $3.5 million, $2.8 million, and $2.2 million for the years ended December 31, 2006, 2005, and 2004, respectively.

As of December 31, 2006, the Company had net operating loss carry-forwards for federal income tax reporting purposes of approximately $26.5 million that will begin to expire starting in 2018 through 2026 if not utilized. The Company had state net operating loss carry-forwards of approximately $29.0 million which expire depending on the rules of the various states to which the net operating loss is allocated. Approximately $600,000 of net operating loss carry-forwards as of December 31, 2006 were attributable to deductions associated with the exercise of Company stock options, the benefit of which will be credited to additional paid-in capital when realized.

The Company also has alternative minimum tax credit carry-forwards of approximately $69,000 that have no expiration date.

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During 2005, the Company s 2003 tax year was examined by the IRS, which resulted in an increase of tax of approximately $51,000. The IRS examination also impacted the tax basis of certain assets resulting in changes to both deferred tax assets and deferred tax liabilities.

Years prior to 2002 are closed to examination for federal income tax purposes. The Company has evaluated the available evidence about both asserted and unasserted income tax contingencies for income tax returns filed with the Internal Revenue Service, state and local tax authorities and has not recorded any income tax contingencies which represent managements estimate of the amount that is probable and estimable of being payable, if successfully challenged by such tax authorities, under the provision of SFAS No. 5, *Accounting for Contingencies* .

NOTE 12 CAPITAL TRANSACTIONS

Preferred Stock: The Board of Directors is authorized to issue shares of the Company s authorized but un-issued preferred stock in one or more series. With respect to any series, the Board of Directors is authorized to determine the number of shares that constitutes such series; the rate of dividend, if any, payable on shares of such series; whether the shares of such series shall be cumulative, non-cumulative, or any other characteristics, preferences, limitations, rights, privileges, immunities, or terms.

Series A 8 percent Cumulative Convertible Preferred Stock: During 1999, the Board of Directors authorized the issuance of 2 million shares of Series A 8 percent Cumulative Convertible Preferred Stock (Series A Preferred Stock) at an offering price of $2.00 per share. Gross proceeds of $4 million were raised upon sale of the shares. During 2004, four stockholders converted 111,007 Series A preferred shares into common shares.

Series B - 8 percent Cumulative Convertible Preferred Stock: In September 2000, the Board of Directors authorized the issuance of 1.2 million shares of Series B 8 percent Cumulative Convertible Preferred Stock (Series B Preferred Stock) and related warrants to purchase common shares at an offering price of $10.00 per unit. Each unit consisted of one share of Series B Preferred Stock and five warrants to purchase one share of common stock at an exercise price of $2.50 per share. During 2000, various investors made loans to the Company and subsequently elected to exchange their promissory notes for units. In addition to the converted loans of $2.5 million, the Company raised $2.0 million through the issuance of units through December 31, 2000 and $1.1 million through the issuance of units in 2001.

As part of the Series B Preferred Stock offering, the Company issued 2.3 million warrants to purchase common stock at $2.50 per share. During the three months ended March 31, 2001, the Company issued an additional 110,000 shares of preferred stock and 550,000 warrants to purchase common stock.

In December 2002 UCN agreed to purchase certain assets and assume certain liabilities of Acceris Communications Inc. (formerly I-Link, Inc.) and its subsidiary, I-Link Communications, Inc. In consideration, UCN issued to Acceris 246,430 shares of Series B Convertible Preferred Stock with a fair market value of $1.4 million, and agreed to issue an additional 53,570 shares of Series B Convertible Preferred Stock in equal monthly installments over a term of 10 months commencing June 1, 2003. The final installment was issued March 1, 2004. In March 2004, Acceris elected to convert all 300,000 shares of Series B Preferred Stock into 1.5 million shares of common stock.

During 2004, stockholders converted a total of 40,000 Series B Preferred shares into 200,000 common shares. During 2003, stockholders converted a total of 116,000 Series B Preferred shares into 580,000 common shares.

Cumulative dividends accrued on both Series A and B Preferred Stock at the rate of 8 percent per annum from the date of original issue and were payable semi-annually on June 30 and December 31 of each year out of funds legally available for the payment of dividends. Dividends were payable in cash or common stock at the election of the Company. If paid in common stock, the number of shares issued was based on the average of the closing bid prices for the common stock over the five trading days immediately prior to the dividend payment date. If the Company failed to pay any dividend within 60 days of its due date, the conversion price (see below) was adjusted downward by $0.25 per share for each occurrence. During the years ended December 31, 2005 and 2004, the Company declared dividends aggregating $38,000 and $672,000, respectively, and to satisfy payment obligations, issued a total of 116,957 and 290,294 shares of common stock, respectively. At December 31, 2004, the Company had accrued dividends payable in the amount of $313,000. In February 2005, the Company settled those dividends payable, along with $38,000 in dividends accrued during January 2005, by issuing 116,957 shares of common stock.

In December 2004 UCN gave notice to the remaining preferred stockholders that it was redeeming all outstanding shares of both series on January 29, 2005. At that time, there were 1.8 million shares of Preferred Series A Stock outstanding with a total redemption value of approximately $3.5 million, and 397,800 shares of Preferred Series B Stock outstanding with a total

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redemption value of $4.0 million. By January 28, 2005 all remaining preferred stockholders had elected to convert their preferred shares to common. Accordingly, all remaining shares of Series A and B Preferred Stock were converted to a total of approximately 3.7 million shares of UCN common stock. Subsequent to the conversion of all outstanding preferred shares, a final dividend payment totaling 116,957 shares of common stock was issued.

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

In conjunction with the 1.96 million shares sold in May 2006, UCN was required to pay down $1.1 million of the original $4.5 million balance of the convertible note (Note 7). At December 31, 2006, the note could have been converted into 1.1 million shares of UCN common stock. The note is convertible at $3.00 per share and UCN can force conversion at $4.80 per share.

On June 23, 2006, a registration statement was filed with the SEC on Form S-1 to register for resale the 1.96 million common shares sold in May 2006, the common shares issuable on conversion of the convertible term note issued to ComVest Capital, and the common shares issuable on exercise of the warrant issued to ComVest Capital. The registration statement became effective on July 17, 2006.

During 2006, employees and former employees exercised the option to purchase 313,835 shares of our common stock. We received total proceeds of $749,000.

In November and December 2005 the Company closed a private placement to institutional and accredited investors. The Company sold 2.2 million shares of common stock at $2.00 per share, or a total of approximately $4.4 million. Net proceeds of the offering after placement fees and expenses were approximately $4.1 million. In addition, 132,000 shares of stock were issued to the investment banking firm as a sales commission valued at $1.95 per share, the fair market value on the day the shares were issued. As part of the offering, five-year warrants to purchase 550,000 shares of common stock at $2.00 per shares were issued to the investors. The fair market value of the warrants, using the Black-Scholes pricing model, was $464,000 with an assumed expected volatility of 43.03%, a risk-free rate of return of 4.47%, a dividend yield of none, and an expected life of 5 years. After allocating the fair market value of the warrants, the intrinsic value of the beneficial conversion feature of $352,000 was reflected as a decrease to additional paid-in capital. On December 29, 2005, the Company filed a registration statement with the Securities and Exchange Commission on Form S-1 to register these shares.

In connection with the MyACD, Inc. acquisition, the Company issued 562,985 shares of UCN common stock valued at $2.28 per share as of the day the parties agreed on payment terms. These shares were issued as part of the purchase agreement to acquire 100% of the shares of MyACD (Note 2).

During 2005, investors and employees exercised options and warrants for a total of 69,267 shares of common stock. Total proceeds received by the Company were $156,000

In 2004 UCN adopted the 2005 Employee Stock Purchase Plan. The purpose of the Purchase Plan is to promote UCN s operating performance and growth potential by encouraging employees to acquire equity in UCN, thereby aligning their long-term interests with those of UCN. The Purchase Plan provides that up to 1,000,000 shares of common stock may be sold to participating employees. It expires at the beginning of 2014. The Compensation Committee of the Board of Directors administers the Purchase Plan.

The Purchase Plan permits eligible employees to purchase UCN common stock through payroll deductions during 35 consecutive participation periods beginning in 2005. Each participation period is three months in length. In general, eligible employees can elect for each participation period to purchase full shares through payroll deductions of up to 10 percent of base pay, but in no event may the participant s rights to purchase shares of common stock accrue at a rate that exceeds $25,000 of fair market value of common stock in a calendar year. The purchase price a participant pays for the shares is equal to the greater of $2.00 or 85 percent of the closing market bid price of the common stock on the first business day or the last business day of each participation period, whichever is lower. This percentage may be changed prior to a participation period by at the sole discretion of, the committee administering the Purchase Plan to any whole percentage that is not less than 85 percent and not greater than 100 percent.

Eligibility to participate is extended to all regular employees of UCN and its participating subsidiaries. Officers and members of the Board of Directors who are eligible employees are also permitted to participate. An employee is ineligible to participate if immediately after a grant the employee would own stock possessing five percent or more of the total combined voting power or value of all classes of stock of UCN.

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The Purchase Plan may be amended by the Board of Directors from time to time as it deems desirable without approval of the stockholders of the UCN, except to the extent stockholder approval is required by Rule 16b-3 of the Exchange Act, applicable NASDAQ or stock exchange rules, applicable provisions of the Internal Revenue Code, or other applicable laws or regulations. The Board of Directors may terminate the plan at any time in its sole discretion. No employee of the Company participated in the plan during 2006 or 2005.

During 2004 note holders converted approximately $1.0 million of promissory notes into 506,250 shares of common stock at a conversion price of $2.00 per share. One of the investors was a member of the Board of Directors who converted an $113,000 note into 56,250 shares of common stock. Another investor was a former member of the Board of Directors who converted notes in the amount of $500,000 into 250,000 shares of common stock.

In March 2004 the Company closed a private placement to institutional and accredited investors. The Company sold approximately 3.8 million shares of common stock at $2.30 per share, or a total of approximately $8.7 million. Net proceeds of the offering after placement fees and expenses were approximately $8.1 million. A portion of the expenses associated with this transaction was the issuance to the investment banking firm of 164,125 warrants to purchase common shares at $2.76 per share that expire March 15, 2007. The fair market value of the warrants, using the Black-Scholes pricing model, was $189,000 with an assumed expected volatility of 65.60%, a risk-free rate of return of 1.97%, a dividend yield of none, and an expected life of 3 years. In connection with the placement, Acceris Communications Inc., formerly I-link Incorporated and the holder of 300,000 shares of Series B Convertible Preferred Stock, converted all of its preferred stock to 1.5 million common shares. Acceris subsequently sold 750,000 of those common shares to the investors in the private placement at $2.30 per share.

In January and February 2004, three Directors exercised options to purchase a total of 255,000 shares of common stock. Total proceeds received by the Company in connection with these exercises was $555,000. Primarily during the quarter ended December 31, 2004, other UCN employees exercised options to purchase a total of 173,128 common shares for proceeds of $389,000.

In December 2003, a holder of 100,000 shares of Series B Convertible Preferred Stock converted all of those shares to 500,000 shares of common stock. In January 2004, the holder sold those common shares plus 14,560 additional shares, or a total of 514,560 shares, back to UCN for $500,000 in a privately negotiated transaction.

Warrants to Purchase Common Shares: As part of the convertible term note and revolving credit note agreement, UCN issued detachable five-year warrants to ComVest Capital, LLC to purchase 330,000 shares of common stock at $2.75 per share. The fair market value of the warrants, using the Black-Scholes pricing model, was $567,000 with an assumed expected volatility of 73.73%, a risk-free rate of return of 4.98%, no dividend yield, and an expected life of 5 years. UCN allocated the proceeds received on the debt financing to the convertible term note, revolving credit note and detachable warrants on a prorated basis based on the fair value of the respective instruments (Note 7). Based on the relative fair value of the instruments, UCN allocated $542,000 to the detachable warrants issued to ComVest.

On June 23, 2006, a registration statement was filed with the SEC on Form S-1 to register for resale the 1.96 million common shares sold in May 2006, the common shares issuable on conversion of the convertible term note issued to ComVest Capital, and the common shares issuable on exercise of the warrant issued to ComVest Capital. The registration statement became effective on July 17, 2006.

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All warrants were exercisable at December 31, 2006. The following tables summarize the warrant activity for the three year period ended December 31, 2006 (in thousands except per share data):

	Outstanding Warrants	Price Range	Weighted Average Exercise Price
Balance at January 1, 2004	4,850	$ 1.25 - $2.50	$ 2.05
Cancelled and expired	(181)	2.00 - 2.50	2.40
Exercised	(2,594)	1.25 - 2.50	2.00
Issued	255	2.76 - 4.00	3.20
Balance at December 31, 2004	2,330	2.00 - 4.00	2.20
Cancelled and expired	(2,062)	2.00 - 2.50	2.07
Exercised	(4)	2.00	2.00
Issued	550	2.00	2.00
Balance at December 31, 2005	814	2.00 - 4.00	2.38
Cancelled and expired	330	2.75	2.75
Issued	(10)	2.50	2.50
Balance at December 31, 2006	1,134	$ 1.25 - $2.75	$ 2.49

A summary of the warrants outstanding and warrants exercisable at December 31, 2006 is as follows (in thousands except per share data):

	Warrants Outstanding			Warrants Exercisable	
Range of Exercise Prices	Warrants Outstanding	Average Remaining Contractual Life	Weighted Average Exercise Price	Warrants Exercisable at December 31, 2006	Weighted Average Exercise Price
$2.00	550	3.9 Years	$ 2.00	550	$ 2.00
2.75 - 2.76	494	2.3 Years	2.75	494	2.75
$4.00	90	0.3 Years	$ 4.00	90	$ 4.00

NOTE 13 STOCK-BASED COMPENSATION

The Company s stock-based compensation primarily consist of the following plans:

Long-Term Stock Incentive Plan: Effective March 11, 1999, the Company established the Long-Term Stock Incentive Plan (the Stock Plan). The Stock Plan provides for a maximum of 1,200,000 shares of common stock of the Company to be awarded to participants and their beneficiaries. A Committee, as determined by the Board of Directors, determines and designates the eligible participants and awards to be granted under the Stock Plan. The Committee may grant incentive stock options; non-qualified options; stock appreciation rights (SAR); and on a limited basis, stock awards. The terms and exercise prices of options and SARs will be established by the Committee; except that the exercise prices cannot be less than 100 percent of the fair market value of a share of common stock on the date of grant. As of December 31, 2006, incentive stock options to purchase a total of 876,816 shares had been granted, and had either been exercised or were outstanding.

Other Options: The Company s Board of Directors has from time to time authorized the grant of stock options to directors, officers, key employees, and consultants as compensation and in connection with obtaining financing.

UCN will receive the proceeds from exercise of the warrants and options and will benefit from extinguishment of the debt represented by the convertible notes, but will not receive any proceeds or benefit from the resale of the shares by the selling security holders.

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Prior to the adoption of SFAS 123(R): The following table illustrates the previously disclosed proforma effects on net income and net income per share for the years ended December 31, 2005 and 2004 if the Company had accounted for its stock option plans under the fair value method of accounting under SFAS 123(R) (in thousands, except per share data):

	December 31, 2005	December 31, 2004
Net loss applicable to common stockholders:		
As reported	$ (8,185)	$ (2,785)
Pro forma stock-option based compensation	(582)	(422)
Pro forma net loss applicable to common stockholders	$ (8,767)	$ (3,207)
Weighted average common shares outstanding		
Basic and diluted as reported	20,669	12,621
Net loss per common share		
Basic and diluted as reported	$ (0.40)	$ (0.22)
Basic and diluted pro forma	$ (0.42)	$ (0.25)

Adoption of SFAS 123(R): For the year ended December 31, 2006, the adoption of SFAS No. 123(R) resulted in incremental stock-based compensation expense of $558,000, which has been allocated to the respective departments based on location of where the employee s regular compensation is charged as follows (in thousands):

	December 31, 2006
Costs of revenue	$ 11
Selling and promotion	222
General and administrative	284
Research and development	41
Total	$ 558

UCN received an income tax benefit of $48,000 during 2006 related to stock-based compensation expense and recorded a deferred tax asset of $163,000 (Note 11). The deferred tax asset has a full valuation allowance recorded against it.

The Company recognizes stock-based compensation expense (net of a forfeiture rate) for those awards which are expected to vest over the requisite service period. The Company estimated the forfeiture rate based on our historical experience and expectations about future forfeitures. As of December 31, 2006, the total remaining unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately $414,000 and is expected to be recognized over a weighted average period of 3.7 years. UCN adopted SFAS 123(R) using the modified prospective transition method which requires the application of the accounting standard starting from January 1, 2006; therefore the financial statements from prior periods have not been restated to reflect the impact of adopting this standard. The Consolidated Financial Statements, for the year ended December 31, 2006, reflect the impact of SFAS 123(R).

UCN estimated the fair value of options granted under our employee stock-based compensation arrangements at the date of grant using the Black-Scholes model with the following weighted-average assumptions for the years ended December 31, 2006, 2005 and 2004:

	December 31, 2006	December 31, 2005	December 31, 2004
Dividend yield	None	None	None
Volatility	71%	46%	63%
Risk-free interest rate	4.65%	4.10%	3.46%
Expected life (years)	3.3	5.0	5.0
Weighted average fair value of grants	$ 1.32	$ 0.85	$ 1.46
Forfeiture rate	5.3%	n/a	n/a

Due to the significant volatility in UCN s stock price, volatility was calculated based on the term of the option. The average risk-free interest rate is determined using the U.S. Treasury rate in effect as of the date of grant based on the term of the of the stock option. UCN calculates the expected term for option grants using the short cut method allowed under SAB 107 by averaging the vesting and contractual term for each vesting period. Generally, employee options vest over a period of from one to three years, and expire from four to five years after the date the options were granted.

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The following tables summarize all stock option activity during the three-years ended December 31, 2006, 2005 and 2004, respectively (in thousands except per share data):

	Options	Exercise Price Per Share	Weighted Average Exercise Price	Intrinsic Value
Balance at January 1, 2004	3,432	$ 2.00 - $5.39	$ 2.62	$ 1,875
Granted	759	2.00 - 3.05	2.60	
Exercised	(428)	2.00 - 2.50	2.20	$ 317
Cancelled or expired	(260)	2.00 - 3.05	2.57	
Balance at December 31, 2004	3,503	2.00 - 5.39	2.67	$ 1,319
Granted	1,254	2.00 - 3.00	2.16	
Exercised	(65)	2.00 - 2.50	2.40	$ 22
Cancelled or expired	(1,166)	2.00 - 5.06	3.07	
Balance at December 31, 2005	3,526	2.00 - 5.39	2.37	$
Granted	366	2.00 - 3.17	2.60	
Exercised	(314)	2.00 - 2.50	2.39	$ 157
Cancelled or expired	(415)	2.00 - 3.69	2.33	
Balance at December 31, 2006	3,163	$ 2.00 - $5.39	$ 2.39	$ 1,627

UCN received cash proceeds from the exercise of options of $749,000, $148,000, and $943,000 respectively, December 31, 2006, 2005 and 2004.

A summary of the options outstanding and options exercisable at December 31, 2006 is as follows (in thousands, except per share amounts):

	Options Outstanding			Options Exercisable	
Exercise price range	Options	Average Remaining Contractual Life	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
$2.00 - $2.30	1,553	3.3 years	$ 2.04	1,007	$ 2.04
2.31 - 2.66	906	2.3 years	2.50	847	2.50
2.67 - 3.07	510	2.7 years	2.79	466	2.78
$3.08 - $5.39	194	4.7 years	3.71	46	5.39
	3,163	3.1 years	$ 2.39	2,366	$ 2.41
Intrinsic value	$ 1,627			$ 1,032	

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A summary of the activity for non-vested share awards as of December 31, 2006, 2005 and 2004, respectively (in thousands, except per share amounts):

	Options	Weighted Average Option Fair Value
Balance at January 1, 2004	686	$ 1.36
Granted	754	1.46
Vested	(265)	1.40
Cancelled or expired	(215)	1.52
Balance at December 31, 2004	960	1.40
Granted	1,254	0.85
Vested	(611)	1.09
Cancelled or expired	(456)	1.19
Balance at December 31, 2005	1,147	1.05
Granted	366	1.32
Vested	(566)	1.09
Cancelled or expired	(150)	1.28
Balance at December 31, 2006	797	$ 1.10

NOTE 14 RELATED PARTY TRANSACTIONS

The Company paid the Chairman of the Board of Directors (the Chairman), for consulting, marketing, and capital raising activities. The Company incurred $55,000, $55,000, and $78,000 in fees associated with these services for the years ended December 31, 2006, 2005 and 2004, respectively. At December 31, 2005, 2004 and 2003, the Company owed the Chairman $5,000, $5,000, and $0, respectively. The Chairman has also provided certain vendors of the Company with his personal guaranty in the amount of up to $800,000, for which UCN has agreed to indemnify him for any losses for which he may become liable.

There have also been several debt arrangements with directors (Note 7), which were repaid during 2006. Interest expense incurred on obligations owed to these directors during 2006, 2005 and 2004, respectively, was approximately $4,000, $274,000 and $219,000.

NOTE 15 MAJOR SUPPLIERS

Approximately 65 percent, 62 percent, and 70 percent of the Company s cost of revenue for the years ended December 31, 2006, 2005 and 2004, respectively, was generated from three of the largest United States telecommunication providers. As of December 31, 2006 and 2005, respectively, the Company owed approximately $4.8 million and $4.1 million to these three providers. The Company has entered into contractual agreements with these vendors (Note 16).

NOTE 16 COMMITMENTS AND CONTINGENCIES

At December 31, 2006, the Company is potentially liable under surety bonds aggregating $156,000 in favor of five municipalities with whom UCN has contracts to provide long distance services. The municipalities routinely require all telecommunication service providers to maintain such surety bonds.

At December 31, 2006, as part of the telecommunication service contracts with two of its wholesale providers, the Company agreed to purchase services which obligate UCN for a combined minimum of approximately $500,000 per month until March 2008.

UCN is the subject of certain other legal matters which it considers incidental to its business activities. It is the opinion of management, after discussion with legal counsel, that the ultimate disposition of these other matters will not have a material impact on the financial position, liquidity or results of operations of the Company.

NOTE 17 SEGMENTS

UCN manages its business based on two customer segments: Telecom and inContact. The Telecom segment includes all voice and data long distance services provided to customers not utilizing any inContact services. The inContact segment

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includes revenues from customers using any inContact services as well as their long distance voice and data services. InContact services include automatic call distribution, interactive voice response, data storage, email, chat, computer telephony integration, call recording, conferencing and reporting.

For the year ended December 31, 2006, inContact segment revenue of $15.2 million includes $11.2 million of related long distance voice and data services and $4.0 million of inContact technology services. For the year ended December 31, 2005, inContact segment revenue of $5.2 million includes $3.9 million of long distance voice and data services and $1.3 million of inContact technology services. Management will continue to evaluate the components of the inContact segment as future strategic initiatives are implemented.

Operating segment revenues and profitability for the year ended December 31, 2006 and 2005 were as follows (in thousands):

	Year Ended December 31, 2006		
	Telecom	**inContact**	**Consolidated**
Revenue	$ 67,635	$ 15,165	$ 82,800
Cost of revenue	45,897	7,558	53,455
Selling and promotion	8,059	5,989	14,048
General and administrative	9,324	3,740	13,064
Depreciation and amortization	5,380	2,077	7,457
Research and development		1,247	1,247
Loss from operations	$ (1,025)	$ (5,446)	$ (6,471)

	Year Ended December 31, 2005		
	Telecom	**inContact**	**Consolidated**
Revenue	$ 76,433	$ 5,154	$ 81,587
Cost of revenue	51,570	2,633	54,203
Selling and promotion	12,313	828	13,141
General and administrative	12,487	756	13,243
Depreciation and amortization	6,368	829	7,197
Research and development		1,308	1,302
Loss from operations	$ (6,305)	$ (1,200)	$ (7,499)

As discussed in Note 2, UCN closed the MyACD acquisition in January 2005. This acquisition is the cornerstone for the inContact suite of services and as such there were no revenues or expenses related to the segment prior to the acquisition, therefore there are no segment results presented for the year ended December 31, 2004.

NOTE 18 SUBSEQUENT EVENTS

Early in 2007, UCN closed two strategic acquisitions, which significantly augmented the overall suite of services. Through these acquisitions, UCN can now offer companies the ability to monitor customer satisfaction and agent effectiveness through its ECHO product as well as efficiently staff their call center using our work force management solution.

BenchmarkPortal, Inc. (ECHO) Acquisition

On February 9, 2007, UCN closed the acquisition of BenchmarkPortal, Inc. (BMP). Through the acquisition UCN acquired a call center survey and analysis business, operated under the name of ECHO . The ECHO business includes: 1) a customer base; 2) automated survey and analysis software and related service offerings; and 3) the related sales, marketing and technical staff. As consideration for the agreement, UCN paid the following consideration:

$500,000 in cash to or for the benefit of the BMP stockholders at closing;

1,535,836 shares of its restricted common stock to BMP stockholders;

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$2.0 million of additional cash to BMP stockholders in 36 equal monthly installments of $55,556, subject to adjustment if monthly recurring revenue during the payout period from customers accounts acquired in the transaction do not remain at certain levels, which are adjusted for estimated attrition; and

An additional $7.0 million maximum contingent quarterly earn out to BMP stockholders paid on a variable percentage of recurring revenue from the sale of ECHO services during the four-year period after closing in excess of $900,000 per quarter.

Prior to the closing of the acquisition, BMP distributed to its stockholders on a pro rata basis cash and property with a total value of approximately $184,000 into a shareholder representative account to satisfy all remaining liabilities of BMP stockholders. After all liabilities are satisfied under the acquisition agreement, the shareholder representative will distribute all remaining funds to stockholders. In addition, prior to closing the acquisition BMP sold certain assets not used in operating the ECHO business at a total purchase price of $91,000 to BenchmarkPortal, LLC, a Delaware limited liability company formed by certain former officers, directors and principal stockholders of BMP. UCN and BenchmarkPortal have entered into agreements pursuant to which:

UCN is entitled to use on an exclusive basis for a term of three years BenchmarkPortal s RealityCheck service with prospects for UCN services to facilitate the sales effort in exchange for payment to BenchmarkPortal of a fee based on revenue generated by prospects who become customers of UCN following the RealityCheck service, and

UCN is entitled to offer, for a term of three years, through its sales channel, as an independent sales agent, other services of BenchmarkPortal in exchange for a sales commission equal to a percentage of the revenue generated from the sale, which varies depending on the BenchmarkPortal service sold.

UCN also entered into a consulting agreement with Dr. Jon Anton, BMP s founder, and employment agreements with Anita Rockwell, BMP s former president, and David Machin, BMP s former Chief Technical Officer. UCN also issued to ComVest Capital LLC a warrant to purchase 55,000 shares of common stock at an exercise price of $2.90 per share that expires May 23, 2011 and paid $40,000 in cash consideration for approval of the transaction.

ScheduleQ Acquisition

On October 19, 2006, UCN entered into a Reseller License Agreement with ScheduleQ, LLC. Under the terms of the license agreement, UCN acquired a limited exclusive right and continuing non-exclusive right to market and distribute ScheduleQ software and services to end-users. ScheduleQ software and services consist primarily of a platform-based workforce management system for call centers, which can operate through our inContact service. At the same time UCN entered into a Purchase Option Agreement with ScheduleQ and the members of that limited liability company. On February 9, 2007, UCN exercised it option to purchase ScheduleQ, which closed on February 15, 2007. To complete the transaction, UCN paid former members of ScheduleQ the following consideration:

Non-interest bearing promissory notes in the in the aggregate principal amount equal $360,676 paid in 48 equal monthly installments, which are secured by the ScheduleQ software code and any improvements thereto;

108,912 restricted common shares of UCN;

Paid liabilities of ScheduleQ in the amount of $256,324; and

An earn out to be paid over a term of 48 months based on the number of ScheduleQ licenses sold by UCN with a minimum aggregate earn out payment of $100,000 and a maximum of $982,000.

ComVest Capital

On January 31, 2007, UCN amended its Revolving Credit Note and Term Loan Agreement, which eliminated the fixed charge coverage ratio and instituted a combined minimum of $3.0 million of cash and availability under the Revolving Credit Note. Additionally, the amendment also changed the capital expenditure and EBITDA (a non-GAAP measure that was specifically defined in the agreement) financial covenants and delayed the first principal payment until November 2007. In consideration of the amendment, we paid ComVest a fee of $35,000.

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UCN, INC.

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

(in thousands)

Description	Balance at beginning of year	Charged to costs and expenses	Write-offs, net of recoveries	Balance at end of year
2006:				
Allowance for uncollectible accounts receivable:	$ 1,596	$ 1,095	$ 945	$ 1,746
2005:				
Allowance for uncollectible accounts receivable:	$ 1,098	$ 1,596	$ 1,098	$ 1,596
2004:				
Allowance for uncollectible accounts receivable:	$ 2,931	$ 1,455	$ 3,288	$ 1,098

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