ATSI COMMUNICATIONS INC/DE
Form 10-Q
March 18, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE
-
ACT OF 1934
For the quarterly period ended January 31, 2002

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 0-23007

ATSI COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware	74-2849995
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6000 Northwest Parkway, Suite 110
San Antonio, Texas 78249
(210) 547-1000
(Address, including zip code, of registrant's principal executive offices and telephone number, including area code)

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 X No
-

The number of shares outstanding of the registrant's common stock at March 10, 2002 was 91,070,380

ATSI COMMUNICATIONS, INC.
AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JANUARY 31, 2002

INDEX

ATSI COMMUNICATIONS, INC.
AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share information)

ASSETS

CURRENT ASSETS:
Cash and cash equivalents
Accounts receivable, net of allowance of $92 and $124, respectively
Inventory
Prepaid expenses & other current assets

Total current assets

PROPERTY AND EQUIPMENT (At cost):
Less - Accumulated depreciation and amortization

Net property and equipment

OTHER ASSETS, net

Goodwill, net
Concession cost, net
Cute FTP costs, net
Other

Total assets

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:
Accounts payable
Accrued liabilities
N/P current
Current portion of obligations under capital leases
Deferred revenue

Total current liabilities

LONG-TERM LIABILITIES:
Obligations under capital leases, less current portion
Customer deposits

Total long-term liabilities

Minority Interest

COMMITMENTS AND CONTINGENCIES:

REDEEMABLE PREFERRED STOCK
Series D Cumulative Convertible Preferred Stock, 3,000 shares authorized, 1,642 shares issued and outstanding at July 31, 2001, 742 shares issued and outstanding at January 31, 2002
Series E Cumulative Convertible Preferred Stock, 10,000 shares authorized, 3,490 shares issued and outstanding at July 31, 2001, 1,655 shares issued and outstanding at January 31, 2002
STOCKHOLDERS' EQUITY:
Preferred stock, $0.01 par value, 10,000,000 shares authorized
Series A Cumulative Convertible Preferred Stock, 50,000 shares authorized, 4,370 shares issued and outstanding at July 31, 2001 and January 31, 2002, respectively
Series F Cumulative Convertible Preferred Stock, 10,000 shares authorized, 9,210 shares issued and outstanding at July 31, 2001 and January 31, 2002, respectively
Series G Cumulative Convertible Preferred Stock, 42,000 shares authorized, 6,500 shares issued and outstanding at July 31, 2001 and January 31, 2002, respectively
Common stock, $0.001 par value, 200,000,000 shares authorized, 77,329,379 issued and outstanding at July 31, 2001 91,070,308 issued and outstanding at January 31, 2002
Additional paid in capital
Accumulated deficit
Warrants outstanding
Deferred compensation
Other comprehensive loss

Total stockholders' equity

Total liabilities and stockholders' equity

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

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ATSI COMMUNICATIONS, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(unaudited)

	Three months ended January 31,		Six months ended
	2001	2002	2001
OPERATING REVENUES:			
Telco services			
Carrier services	4,422	$ 11,051	8,068
Network services	700	612	1,406
Retail services	1,674	1,932	3,399
Internet e-commerce	1,254	1,235	2,676
Total operating revenues	$ 8,050	$ 14,830	$ 15,549
OPERATING EXPENSES:			
Cost of services	5,417	11,319	10,945
Selling, general and administrative	4,057	3,996	9,278
Bad debt expense	79	88	130
Depreciation and amortization	1,087	1,163	2,236
Total operating expenses	10,640	16,566	22,589
Operating loss	(2,590)	(1,736)	(7,040)
OTHER INCOME(EXPENSE):			
Other income (expense), net	477	(49)	701
Interest expense	(377)	(539)	(810)
Total other income (expense)	100	(588)	(109)
LOSS BEFORE INCOME TAX EXPENSE (BENEFIT)	(2,490)	(2,324)	(7,149)
INCOME TAX EXPENSE (BENEFIT)	(1)	31	64
MINORITY INTEREST	88	(9)	129
NET LOSS	(2,401)	(2,364)	(7,084)
LESS: PREFERRED DIVIDENDS	(233)	(132)	(1,121)
NET LOSS TO COMMON STOCKHOLDERS	$ (2,634)	$ (2,496)	$ (8,205)

BASIC AND DILUTED LOSS PER SHARE	$ (0.04)	$ (0.03)	$ (0.12)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	69,071	83,127	67,654

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

ATSI COMMUNICATIONS, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(unaudited)

	For the three months ended January 31,		F
	2001	2002	
Net loss to common stockholders	($2,634)	($2,496)	(
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustments	($245)	$ 1	
Comprehensive loss to common stockholders	($2,879)	($2,495)	(

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

ATSI COMMUNICATIONS, INC.
AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)
(unaudited)

	Six months ended January 3	
	2001	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(7,084)	$(4,492
Adjustments to reconcile net income to net cash provided by (used in) operating activities-		

Depreciation and amortization	2,236	2,289
Amortization of debt discount	129	--
Deferred compensation	277	12
Minority Interest	(127)	17
Provision for losses on accounts receivable	130	114
Changes in operating assets and liabilities- net of effects from acquisition		
Change in accounts receivable	721	484
Change in other assets-current and long-term	(362)	117
Change in accounts payable	2,310	1,912
Change in accrued liabilities	(179)	553
Change in deferred revenue	(90)	12
Net cash (used in) provided by operating activities	(2,039)	1,018
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property & equipment	(604)	(624
Net cash used in investing activities	(604)	(624
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of debt	428	11
Principal payments under capital lease obligations	(602)	(376
Payments on debt	(417)	(65
Net increase in advanced funding arrangements	106	--
Proceeds (costs) from issuance of preferred stock, net	2,249	(14
Proceeds from issuance of common stock, net	86	180
Net cash provided by (used in) financing activities	1,850	(264
Net (decrease) increase in cash	(793)	130
Cash, beginning of period	1,550	103
Cash, end of period	$ 757	$ 233

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

ATSI COMMUNICATIONS, INC.
AND SUBSIDIARIES
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. PRINCIPLES OF CONSOLIDATION AND BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements, which include the following subsidiaries: ATSI-Delaware, ATSI-Canada, ATSI-Texas, ATSI-Mexico, ATSI-COM, Computel, ATSI de CentroAmerica, Telespan, Sinfra and GlobalSCAPE have been prepared in accordance with Rule 10-01 of Regulation S-X, "Interim Financial Statements," and accordingly do not include all information and footnotes required under accounting principles generally accepted in the U.S.

for complete financial statements. In the opinion of management, these interim financial statements contain all adjustments, without audit, necessary to present fairly the consolidated financial position of ATSI and its subsidiaries ("ATSI" or "the Company") as of January 31, 2002, the results of their operations for the three and six months ended January 31, 2001 and 2002, comprehensive loss for the three and six months ended January 31, 2001 and 2002, and cash flows for the six months ended January 31, 2001 and 2002. All adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. It is recommended that these interim consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto for the year ended July 31, 2001 included in the Company's annual report on Form 10-K filed with the SEC on October 30, 2001. Certain prior period amounts have been reclassified for comparative purposes. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142, which supercedes APB Option No. 17, "Intangible Assets" provides financial accounting and reporting for acquired goodwill and other intangible assets. While SFAS 142 is effective for fiscal years beginning after December 15, 2001, early adoption is permitted for companies whose fiscal years begin after March 15, 2001. SFAS 142 addresses how intangible assets that are acquired individually or with a group of assets should be accounted for in financial statements upon their acquisition as well as after they have been initially recognized in the financial statements. While the Company is not yet required to adopt SFAS 142, it believes the adoption will not have a material effect on the financial condition or results of the Company unless at some future time it is determined that an impairment of its intangible assets exists.

2. FUTURE OPERATIONS

The consolidated financial statements of the Company have been prepared on the basis of accounting principles applicable to a going concern. For the period from December 17, 1993 to January 31, 2002, the Company has incurred cumulative net losses of approximately $57.3 million. Further, we have a working capital deficit of approximately $12.2 million at January 31, 2002. We have limited capital resources available to us, and these resources may not be available to support our ongoing operations until such time as we are able to continuously generate positive cash flows from operations. There is no assurance we will be able to achieve future revenue levels sufficient to support operations or recover our investment in property and equipment, goodwill and other intangible assets. These matters raise substantial doubt about our ability to continue as a going concern. Our ability to continue as a

going concern is dependent upon the ongoing support of our stockholders and customers, our ability to obtain capital resources to support operations and our ability to successfully market our services.

We are likely to require additional financial resources in the near term and could require additional financial resources in the long-term to support our ongoing operations. We plan on securing funds through equity offerings and entering into lease or long-term debt financing agreements to raise capital. There can be no assurances, however, that such equity offerings or other financing arrangements will actually be consummated or that such funds, if received, will be sufficient to support existing operations until revenue levels are achieved sufficient to generate positive cash flow from operations. If we are not successful in completing additional equity offerings or entering into other financial arrangements, or if the funds raised in such stock offerings or other financial arrangements are not adequate to support us until a successful level of operations is attained, we have limited additional sources of debt or equity capital and would likely be unable to continue operating as a going concern.

3. PREFERRED STOCK

During the quarter, the holder of the Series E Preferred Stock converted 1,485 of the 3,140 shares outstanding and accumulated interest into common stock resulting in the issuance of 6,295,080 shares of common stock. In accordance with the terms of the Investment Option of the Series E Preferred Stock, the holder purchased an additional 279,720 shares of common stock for $70,000.

Additionally, the holder of the Series D Preferred Stock converted 900 of the 1,642 shares outstanding and accumulated interest into common stock resulting in the issuance of 4,384,990 shares of common stock during the quarter.

4. SEGMENT REPORTING

We have determined that we have three reportable segments: (1) U.S. Telco; (2) Mexico Telco; and (3) Internet e-commerce. Our Internet e-commerce subsidiary, GlobalSCAPE, Inc. and its operations can be differentiated from the telecommunication focus of the rest of ATSI. Additionally, we believe that our U.S. and Mexican subsidiaries should be separate segments even though many of the products are borderless. Both the U.S. Telco and Mexican Telco segments include revenues generated from Retail Services and Network Services. Our Carrier Services revenues, generated as a part of our U.S. Telco segment, are the only revenues not currently generated by both the U.S. Telco and Mexico Telco segments. We have included the operations of ATSI-Canada, ATSI-Delaware and all businesses falling below the reporting threshold in the "Other" segment. The "Other" segment also includes intercompany eliminations.

We have used earnings (loss) before interest, taxes, depreciation and amortization (EBITDA) in our segment reporting as it is the chief measure of profit or loss used in assessing the performance of each of our segments.

	For the three months ended		For the six months ended	
	January 31, 2001	January 31, 2002	January 31, 2001	January 31, 2002
U.S. Telco				
External revenues	$5,040,444	$11,502,404	$9,491,712	$20,979,758
Intercompany revenues	$ 342,140	$ 152,528	$ 870,650	$ 298,711

Total revenues	$ 5,382,584	$11,654,932	$10,362,362
EBITDA	($944,277)	($483,484)	($3,668,193)

Operating loss	($1,440,697)	($946,480)	($4,752,887)
Net loss	($1,049,436)	($974,835)	($4,449,802)
Total assets	$15,683,730	$16,731,394	$15,683,730
Mexico Telco			
External revenues	$ 1,755,505	$ 2,092,912	$ 3,381,406
Intercompany revenues	$ 468,549	$ 483,950	$ 975,795
Total revenues	$ 2,224,054	$ 2,576,862	$ 4,357,201
EBITDA	($517,173)	($260,056)	($1,061,004)
Operating loss	($924,405)	($818,252)	($1,851,928)
Net loss	($1,146,910)	($1,363,071)	($2,250,472)
Total assets	$ 8,766,249	$11,873,607	$ 8,766,249
Internet e-commerce			
External revenues	$ 1,254,048	$ 1,234,815	$ 2,675,880
Intercompany revenues	-	-	-
Total revenues	$ 1,254,048	$ 1,234,815	$ 2,675,880
EBITDA	($35,992)	$ 170,562	($69,012)
Operating income (loss)	($161,797)	$ 28,839	($314,802)
Net income (loss)	($173,016)	$ 32,403	($404,550)
Total assets	$ 1,709,694	$ 1,339,921	$ 1,709,694
Other			
External revenues	-	-	-
Intercompany revenues	($810,689)	($636,478)	($1,846,445)
Total revenues	($810,689)	($636,478)	($1,846,445)
EBITDA	($5,769)	-	($5,769)
Operating loss	($62,841)	-	($120,435)
Net loss	($264,707)	($190,028)	($1,100,006)
Total assets	($1,415,501)	($8,800,482)	($1,415,501)
Total			
External revenues	$ 8,049,997	$14,830,131	$15,548,998
Intercompany revenues	-	-	-
Total revenues	$ 8,049,997	$14,830,131	$15,548,998
EBITDA	($1,503,211)	($572,978)	($4,803,978)

Depreciation and Amortization	($1,086,529)	($1,162,915)	($2,23
Operating loss	($2,589,740)	($1,735,893)	($7,04
Net loss to Common Stockholders	($2,634,069)	($2,495,531)	($8,20
Total assets	$24,744,172	$21,144,440	$24,74

5. CAPITAL LEASES

The Company's current liabilities include a total of $5.8 million owed to NTFC Capital Corporation and IBM de Mexico. The Company classified all amounts as current under the note obligations due to being in technical default on both notes. As such, each lender could call their notes as immediately due and payable. The Company believes the lenders will not call the notes. NTFC has expressed a desire to reset the covenants under the note in an effort to cure past defaults and avoid future defaults, and IBM and the Company have had limited conversations concerning restructuring their note. Although the note terms or covenants could be reset, we can give no assurances that the notes will not be called. All scheduled payments have been made to NTFC as of January 31, 2002; but the Company is approximately $1.6 million behind in payments to IBM.

6. SUBSEQUENT EVENTS

In February 2000, our board of directors approved a plan, in which $1.1 million was loaned, at a market interest rate, in the aggregate to certain key executive officers to allow them to exercise approximately 2,033,332 of their vested options. During fiscal 2001, the board of directors modified the agreements by extending them for an additional year and changing them to non-recourse notes. As the accounting treatment for non-recourse notes is consistent with the treatment for options outstanding, the Company excluded the shares from its outstanding common stock as of the date of the modification. As of January 31, 2002, $51,000 of interest income has been accrued for the period from February 2000 to the date the notes were modified.

In February 2002 the notes expired. The Board of Directors is currently considering either renewing the notes or issuing replacement options.

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

SPECIAL NOTE: Certain Statements set forth below under this caption constitute "forward-looking statements" within the meaning of the Securities Act.

The following is a discussion of the consolidated financial condition and results of operations of ATSI for the three and six months ended January 31, 2001 and 2002. It should be read in conjunction with our Consolidated Financial Statements, the Notes thereto and the other financial information included elsewhere in the annual report on Form 10-K filed with the SEC on October 30, 2001.

General

ATSI Communications, Inc. is an international carrier serving the rapidly expanding communications markets in and between Latin America and the United States. The Company's mission is to connect the Americas with exceptional communications services guided by our core values that drive everything we do. The Company's strategy is to become a dominant provider of services to businesses and consumers in this American/Latin American corridor through the deployment of a high quality, `next generation' network. Founded in 1993, the Company's traffic is generated from more than 650 retail points of presence throughout Mexico, as well as from relationships with major carriers based in the United States. ATSI carries the traffic generated from these sources over a hybrid, redundant satellite and fiber-based ATM network between the United States and Mexico, as well as a satellite-based network between the United States, Costa Rica and El Salvador.

The Company's current core focus today is on the communications corridor between the United States and Mexico. Already one of the two largest international communications corridors in the world, this corridor is growing due to increasing phone density in Mexico and large-scale emigration of Mexicans to the United States. The Company is uniquely positioned within this growing market niche as one of only a handful of viable carriers, and the only operating company whose focus is international services, as opposed to domestic services.

Operationally, the Company's strength lies in its framework of licenses, interconnection agreements and business relationships in Mexico, as well as in its customer relationships and industry knowledge in the United States. The Company has over 400 employees based in Mexico, and operates Mexican subsidiaries with licenses that allow it to sell local and long distance traffic, transport long distance traffic, and operate a network utilizing packet-switching technology. Utilizing these strengths, the Company has leveraged off of the networks of third parties to build a reliable customer base, and has established its own international satellite and fiber-based network to long haul consumer, corporate and carrier-generated traffic between the U.S. and Mexico.

We also own approximately 70% of GlobalSCAPE, Inc., which is rapidly becoming a leader in electronic commerce of top Internet-based software, utilizing the Web as an integral component of its development, marketing, distribution and customer relationship strategies.

As discussed in Note 4 to our consolidated financial statements we have determined that we have three reportable segments: 1) U.S Telco; 2) Mexico Telco; and 3) Internet e-commerce.

Additionally, we have determined that our U.S. and Mexican subsidiaries should be reported as separate segments although many of our products are borderless and utilize the operations of entities in both the U.S. and Mexico. Both the U.S. Telco and Mexico Telco segments include revenues generated from Network Services and Retail Services. All of the carrier services revenues are recorded in the U.S. Telco segment. GlobalSCAPE, Inc. and its operations are accounted for exclusively as a part of the Internet e-commerce operating segment.

Our consolidated financial statements have been prepared assuming that we will continue as a going concern. We have incurred losses since inception and have a working capital deficit as of January 31, 2002. Additionally, we have had recurring negative cash flows from operations with the exception of the quarters ended January 31, 1998, October 31, 2001 and January 31, 2002. For the reasons stated in Liquidity and Capital Resources and subject to the risks referred to in Liquidity and Capital Resources,

we expect improved results of operations and liquidity in the latter half of fiscal 2002. However, we cannot assure you that this will be the case.

Results of Operations

The following table sets forth certain items included in our results of operations in dollar amounts and as a percentage of total revenues for the three and six-month periods ended January 31, 2001 and 2002.

	Three months ended January 31,				Six m
	2001		2002		2001
				(unaudited)	
	$	%	$	%	$
Operating revenues:					
Telco Services					
Carrier services	$ 4,422	55%	$ 11,051	75%	$ 8,068
Network services	700	9%	612	4%	1,406
Retail services	1,674	21%	1,932	13%	3,399
Internet e-commerce	1,254	15%	1,235	8%	2,676
Total operating revenues	8,050	100%	14,830	100%	15,549
Cost of services	5,417	67%	11,319	76%	10,945
Gross margin	2,633	33%	3,511	24%	4,604
Selling, general and administrative expense	4,057	50%	3,996	27%	9,278
Bad debt expense	79	1%	88	1%	130
Depreciation and amortization	1,087	14%	1,163	8%	2,236
Operating loss	(2,590)	(32%)	(1,736)	(12%)	(7,040)
Other, net	100	1%	(588)	(4%)	(109)
Loss before income tax expense and minority interest	(2,490)	(31%)	(2,324)	(16%)	(7,149)
Income tax & minority interest, net	89	1%	(40)	(0%)	65
Net loss	(2,401)	(30%)	(2,364)	(16%)	(7,084)

Less: preferred dividends	(233)	(3%)	(132)	(1%)	(1,121)
Net loss to common stockholders	($2,634)	(33%)	($2,496)	(17%)	($8,205)

Three Months ended January 31, 2002 Compared to Three Months ended January 31, 2001

Operating Revenues. Consolidated operating revenues increased 84% between quarters from $8.1 million to $14.8 million. During the quarter the Company continued to add capacity to its switch and its network backbone in response to the growing demand for its services. The Company also began

its efforts to increase its terminating capacity with third party carriers to process traffic outside of its own network backbone in Mexico.

Telco revenues (all revenues other than e-commerce) increased from $6.8 million to $13.6 million while e-commerce revenues generated by GlobalSCAPE declined by approximately $19,000 between periods.

Carrier services revenues increased approximately $6.6 million, or 150% from the quarter ended January 2001 to the quarter ended January 2002. The increased revenue resulted from an increase in the units transported from approximately 50.3 million units during the quarter ended January 31, 2001 to 113.9 million units during the quarter ended January 31, 2002 and an increase of approximately $0.01 per average unit between quarters.

Network services declined by approximately $88,000 or 13% between periods. Our 800- service business declined between periods by approximately $80,000. The decline is attributed to decreased volume of units transported via our network. Units transported declined from 1.8 million to 1.2 million, period to period. Our private network services remained relatively flat between periods.

Retail services revenues increased approximately $258,000 between periods. Our integrated prepaid revenues within Mexico increased approximately $315,000 between quarters, but this increase was somewhat offset by the continuing decline in postpaid, primarily operated-assisted service revenues. The improved revenues between quarters resulted from our efforts to become more competitive in the products we offered as we evaluated our core business to strategically relocate communication centers to concentrated areas where growth would be realized. As for the declining operated-assisted services, management does not expect postpaid revenues to contribute significantly to the Company's operating results in fiscal 2002.

Our Internet e-commerce services decreased approximately $19,000 between periods.

Cost of Services. Cost of services increased as a percentage of revenue from 67% to 76%, period to period. Cost of services for e-commerce slightly increased from 5% for the quarter ended January 2001 to 10% for the period ended January 2002. The increase was a result of royalty expense being recognized related to the distribution agreement with Trellix Corporation announced on June 6, 2001. Cost of services as a percentage of revenues on the Company's telco business increased slightly from 79% to 82% between quarters. The Company continued to focus on improving carrier services margins quarter to quarter through reductions in variable costs, improvements in the average price per unit and improvements realized from the installation of Nortel Passport equipment in the latter half of fiscal 2001. While the Company recognized higher carrier service margins during the quarter than for the quarter ended January 31, 2001, the increase in carrier services traffic as a percentage of overall revenues from 55% to 75%, between quarters, contributed to the increased cost of services.

Selling, General and Administrative (SG&A) Expenses. SG&A expenses decreased approximately $61,000, or 1.5% between periods. SG&A expenses associated with our e-commerce subsidiary decreased approximately $276,000, or 23% between periods due to the decline in expenses related to research and development, professional fees, recruiting and compensation expense associated with the granting of options. SG&A expenses associated with our telco operations increased approximately 8% or $216,000 between periods but decreased as a percentage of revenues from 42% to 23%.

Bad Debt Expense. Bad Debt Expense increased by approximately 11% or $9,000 between periods due to the recording of an allowance of $37,000 associated with one of the Company's carrier services customers offset by the decline in the Company's postpaid call services business between quarters.

Depreciation and Amortization. Depreciation and amortization increased by approximately 7% or $76,000 between periods.

Operating Loss. The Company's operating loss improved significantly by approximately 33% or $854,000 from the second quarter of fiscal 2001, primarily due to increased revenues and consequently improved gross margins.

Other Income(expense). Other expense increased approximately $688,000 between quarters primarily due to two factors. First, during the quarter ended January 2001, the Company recognized a gain of $500,000 related to the settlement of a litigation case with one of our carrier customers. Secondly, during the quarter ended January 2002, the Company recognized incremental interest expense related to its IBM capital lease of approximately $316,000.

Preferred Stock Dividends. During the quarter ended January 2002, we recorded approximately $132,000 of non-cash dividends related to our cumulative convertible preferred stock. This compares favorably to the approximate $233,000 of non-cash dividends and beneficial conversion feature expense recognized during the quarter ended January 2001.

Net loss to Common Stockholders. The net loss for the quarter ended January 2002 improved by approximately $138,000 to $2.5 million from the $2.6 million net loss for the quarter ended January 2001. The improvement was due primarily to a significant increase in revenues, which improved our gross margin dollars offset by the increase in other expense between quarters.

Six Months Ended January 31, 2002 Compared to Six Months Ended January 31, 2001

Operating Revenues. Consolidated operating revenues increased 76% between periods from $15.5 million for the six months ended January 31, 2002 to $27.4 million for the six months ended January 31, 2002. In response to the increasing demand for its services, the Company began adding capacity to both its switch and its network backbone in October 2001. The Company is also working to increase its terminating capacity with third party carriers to process traffic outside of its own network backbone in Mexico. The net effect of our efforts during the six months led to the highest and third highest quarters of revenues in our history.

Telco revenues (all revenues other than e-commerce) increased from $12.9 million to $25.0 million while e-commerce revenues generated by GlobalSCAPE declined by approximately $202,000 between periods.

Carrier services revenues increased approximately $12.0 million, or 148% from the six months ended January 2001 to the six months ended January 2002. As a result of the Company's effort to add capacity, the units transported via our network more than doubled from approximately 95.7 million units during the period ended January 2001 to approximately 207.5 million units during the period ended January 2002. Additionally, our average price per unit increased approximately $0.01 between periods.

Network services decreased slightly by approximately $130,000 or 9% between periods. Our 800- service business declined between periods by approximately $121,000. The decline is attributed to decreased volume of units transported via our network. Units transported declined from 3.3 million to 2.4 million, period to period. Our private network services remained relatively flat between periods.

Retail services revenues increased approximately $258,000 between periods. Our integrated prepaid revenues within Mexico increased approximately $509,000 between quarters, but this increase was somewhat offset by the continuing decline in postpaid, primarily operated-assisted service revenues.

The improved revenues between quarters resulted from our efforts to become more competitive in the products we offered as we evaluated our core business to strategically relocate communication centers to concentrated areas where growth would be realized. As for the declining operated-assisted services, management does not expect postpaid revenues to contribute significantly to the Company's operating results in fiscal 2002.

Our Internet e-commerce services decreased approximately $202,000, or 8% between periods. The expected elimination of advertising revenue accounted for approximately $27,000 of the decline. As for the remaining decline, it was attributed to a decline in CuteFTP site license sales between periods. This decline, however, was partially offset by the sales of a desktop web-site creation and management tool, and the introduction of CuteFTP Pro. Additionally, other product sales, such as CuteHTML, CuteMAP, and CuteZIP, increased between periods to contribute to the offset.

Cost of Services. Cost of services increased as a percentage of revenue from 70% to 75%, period to period. Cost of services for e-commerce increased from 4% for the six months ended January 2001 to 9% for the six months ended January 2002. This increase was a result of royalty expense being recognized related to the distribution agreement with Trellix Corporation announced on June 6, 2001. Cost of services as a percentage of revenues on the Company's telco business decreased from 84% to 81% between periods. The Company continued to focus on improving carrier services margins period to period through reductions in variable costs, improvements in the average price per unit and improvements realized from the installation of Nortel Passport equipment in the latter half of fiscal 2001.

Selling, General and Administrative (SG&A) Expenses. SG&A expenses decreased approximately $1.5 million, or 16% between periods. SG&A expenses associated with our e-commerce subsidiary decreased approximately $655,000, or 26% between periods due to the decline in expenses related to research and development, recruiting, professional fees and compensation expense associated with the granting of stock options. SG&A expenses associated with our telco operations decreased approximately 12% or $800,000 between periods. This improvement resulted from management's efforts to cut excess spending by each department. Also, during the quarter ended October 2000, telco operations recognized significant expenses related to severance packages, professional fees associated with the Genesis transaction, and strategic research services. As a percentage of revenues, telco SG&A declined from 52% to 24% period to period.

Bad Debt Expense. Bad Debt Expense declined by approximately 12% or $16,000 between periods due primarily to the decline in the Company's postpaid call services business between periods offset by approximately $37,000 of expense related to one of its carrier service customers.

Depreciation and Amortization. Depreciation and amortization slightly increased by approximately 2% or $53,000 between periods.

Operating Loss. The Company's operating loss improved significantly by approximately 53% or $3.7 million period to period, primarily due to increased revenues and consequently increased gross margins and reductions in selling, general and administrative expenses.

Other Income(expense). Other expense increased $1.0 million between periods primarily due to three factors. First, during the quarter ended January 2001, the Company recognized a gain of $500,000 related to the settlement of a litigation case with one of our carrier customers. Secondly, during the six months ended January 31, 2001, the Company recognized a gain related to the extinguishment of a liability for approximately $184,000. Finally, during the six months ended January 31, 2002, the Company recognized approximately $610,000 of incremental interest expense associated with its IBM capital lease.

Preferred Stock Dividends. During the six months ended January 31, 2002, we recorded approximately $277,000 of non-cash dividends related to our cumulative convertible preferred stock. This compares favorably to the approximately $1.1 million of non-cash dividends and beneficial conversion feature expense recognized during the six months ended January 2001.

Net loss to Common Stockholders. The net loss for the six months ended January 2002 improved by approximately $3.4 million to $4.8 million from the $8.2 million net loss for the six months ended January 2001. The improvement was due primarily to a significant increase in revenues, which improved our gross margin dollars. Additionally, the reduction in selling, general and administrative expenses and preferred dividends contributed to our improved net loss to stockholders between periods.

Liquidity and Capital Resources

During the six months ended January 31, 2002, we generated positive cash flows from operations of approximately $1.0 million. The Company was able to generate this positive cash flow from operations by reducing the net loss incurred during the period, shortening the cash conversion cycle of customer receivables, and working with vendors related to payments. As a result, the Company had the ability to operate with minimal assistance from private equity placements or issuances of debt.

For the six months ended January 31, 2002, after adjustments for non-cash items (depreciation and amortization, amortization of debt discount, deferred compensation, provision for losses on accounts receivable and minority interest), we had a net loss of approximately $2.1 million. Management of the operating assets and liabilities, which consist mainly of collections on accounts receivable and payments made on outstanding payables and accrued liabilities, produced positive cash flows of approximately $3.1 million, resulting in positive operating cash flows for the period of $1.0 million. By generating positive cash flows during the six months ended January 31, 2002, we improved over the six months ended January 31, 2001 by $3.1 million or 150% in operating cash flows. Due primarily to the positive operating cash flows produced during the first six months of fiscal 2002, our net loss, after adjustments for non-cash items, significantly improved over the six months ended January 31, 2001, when our net loss, after adjustments for non-cash items, was $4.4 million.

Although we were able to produce positive cash flows from operations during the quarters ended October 31, 2001 and January 31, 2002, we must produce positive cash flows on a recurring basis, and reduce or eliminate our working capital deficit. Until that time, management will be faced with deciding whether to use available funds to pay vendors and suppliers for services necessary for operations, to

service our debt requirements, or to purchase equipment to be used in the growth of our business. Should our available funds not be sufficient to pay vendors and suppliers, to service debt requirements and purchase equipment, we will need to continue to raise additional capital. As noted in the risk factors of the Form 10-K filed with the SEC on October 30, 2001, we have not always paid all of our suppliers on time. Some of these suppliers are critical to our operations. These suppliers have given us payment extensions in the past, although there is no guarantee they will do so in the future.

During the six months ended January 31, 2002, the Company acquired approximately $624,000 in equipment which was not financed through capital lease or financing arrangements. Additional cash outflows included the payment of approximately $376,000 towards our capital lease obligations and an additional $65,000 towards debt.

During the six months ended January 2002, we received cash proceeds, net of issuance costs, of approximately $180,000 from the issuance of common stock as a result of an investment option exercise. These funds along with the cash flows generated from operations were used to pay down payable balances as mentioned above, to make payments on our debt and capital lease obligations, and to purchase additional equipment used in our network operations.

Overall, the Company's net operating, investing and financing activities during the six months ended January 2002 provided approximately $130,000 in cash flows. The Company's working capital deficit at January 31, 2002 was approximately $12.2 million. This represents an increase of approximately $2.9 million from the working capital deficit of $9.3 million at July 31, 2001. The Company's current liabilities include a total of $5.8 million owed to NTFC Capital Corporation and IBM de Mexico. The Company classified all amounts as current under the note obligations due to being in technical default on both notes. As such, each lender could call their notes as immediately due and payable. The Company believes the lenders will not call the notes. NTFC has expressed a desire to reset the covenants under the note in an effort to cure past defaults and avoid future defaults, and IBM and the Company have had limited conversations concerning restructuring their note. Although the note terms or covenants could be reset, we can give no assurances that the notes will not be called. All scheduled payments have been made to NTFC as of January 31, 2002; but the Company is approximately $1.6 million behind in payments to IBM.

The Company's current obligations also include notes payable of approximately $609,000, approximately $1.2 million owed to Northern Telecom for the purchase of equipment during fiscal 2001, and approximately $437,000 owed to the former owners of Grupo Intelcom, S.A. de C.V., the entity purchased by the Company in July 2000 and through which the Company obtained its Mexican long distance concession.

We continue to focus on enhancing the capacity and efficiency of our international network backbone between the U.S. and Mexico, adding alternate carriers to transport our traffic outside of that backbone in Mexico, and changing the mix of our traffic to better utilize our network capabilities. A direct result of our producing positive cash flows from operations relates to the Company's focus on its core revenue stream and reducing the cash conversion cycle of its primary customers. To allow these trends to continue, the Company needs to expand its network and switch capacity in order to provide additional capacity to existing and potential customers.

The Company has limited availability to capital resources, and these resources may not be available to support our ongoing operations until such time as we are able to generate positive cash

flows from operations. There is no assurance we will be able to achieve future revenue levels sufficient to support operations or recover our investment in property and equipment, goodwill and other intangible assets. These matters raise substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern is dependent upon the ongoing support of our stockholders and customers, our ability to obtain capital resources to support operations and our ability to successfully market our services.

Inflation/Foreign Currency

Inflation has not had a significant impact on the Company's operations. With the exception of integrated prepaid revenues from the Company's communication centers and payphones, almost all of the Company's revenues are generated and collected in U.S. dollars. Integrated prepaid services from the Company's communication centers and payphones are provided at the time of the call in exchange for cash payment, so the Company does not maintain receivables on its books that are denominated in pesos. In an effort to reduce foreign currency risk, the Company attempts to convert pesos collected to U.S. dollars quickly and attempts to maintain minimal cash balances denominated in pesos. Some expenses related to certain services provided to the Company are incurred in foreign currencies, primarily Mexican pesos. The devaluation of the Mexican peso over the past several years has not had a material adverse effect on the Company's financial condition or operating results.

Seasonality

The Company's integrated prepaid revenues are typically higher on a per phone and per communication center basis during January through July, the peak tourism months in Mexico.

Market Risk

We are subject to several market risks. Specifically, we face commodity price risks, equity price risks and foreign currency exchange risk.

Commodity Price Risk

Certain of our businesses, namely network services, operate in an extremely price sensitive environment. The network services business over the past twelve months has seen significant reductions in the price per unit charged for transporting traffic. While we have been able to withstand these pricing pressures, certain of our competitors are much larger and better positioned to continue to withstand these price reductions. Our ability to further absorb these price reductions may be dependent on our ability to further reduce our costs of transporting this traffic.

Equity Price Risks

Until such time as we are able to consistently produce positive cash flows from operations, we will be dependent on our ability to continue to access debt and equity sources of capital. While recent history has shown us capable of raising equity sources of capital; future equity financings and the terms of those financings will be largely dependent on our stock price, our operations and the future dilution to our shareholders.

Foreign Currency Exchange Risk

We face two distinct risks related to foreign currency exchange risk; transaction risk and translation risk.

As previously discussed under the caption "Inflation", we face risks related to certain of our revenue streams, namely, integrated prepaid services from our own Mexican communication centers and payphones and the transacting of business in pesos as opposed to U.S. dollars. Historically, we have been able to minimize foreign currency exchange risk by converting from pesos to U.S. dollars quickly and by maintaining minimal cash balances denominated in pesos. As we grow our retail business in Mexico it is likely that we will face increasing foreign currency transaction risks.

Historically, we have recorded foreign currency translation gains/losses in our assets and liabilities due to the volatility of the peso exchange rate as compared to the U.S. dollar over time. We anticipate we will continue to experience translation gains/losses in our assets and liabilities, specifically in fixed assets which are accounted for at historical pesos amounts on the books of our Mexican subsidiaries but converted to U.S. dollars for consolidation purposes at current exchange rates.

PART II OTHER INFORMATION

Item 6 Exhibits and Reports on Form 8-K

(a) Exhibits:

The exhibits listed below are filed as part of this report.

Exhibit Number	
11	Computation of Earnings per Share (Exhibit to this Form 10-Q filed March 18, 2002)

(b) Current Reports on Form 8-K.

On December 18, 2001 the Company filed a Form 8-K announcing that its Board of Directors had approved the recommendation of the Audit Committee that Arthur Andersen LLP be dismissed as independent public accountants. On January 24, 2002 and January 31, 2002 the Company filed Form 8-K/A's noting that the Company was not aware of any disagreements regarding accounting or financial disclosure with Arthur Andersen LLP.

On December 18, 2001 the Company filed a Form 8-K announcing that its Board of Directors had approved the recommendation of the Audit Committee that Ernst & Young LLP be approved as independent public accountants for the fiscal year ending July 31, 2002.

SIGNATURE

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

ATSI COMMUNICATIONS, INC.
(Registrant)

Date:	March 18, 2002	By:	/s/ H. Douglas Saathoff
		Name:	H. Douglas Saathoff
		Title:	Chief Financial Officer