ATSI COMMUNICATIONS INC/DE
Form 10-K/A
March 03, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

(MARK ONE)
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED JULY 31, 2003

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: 1-15687

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.)

8600 WURZBACH, SUITE 700W
SAN ANTONIO, TEXAS 78240
(210) 614-7240
(ADDRESS, INCLUDING ZIP CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES AND TELEPHONE NUMBER, INCLUDING AREA CODE)

Securities Registered Pursuant to Section 12(b) of the Act:
COMMON STOCK, PAR VALUE $0.001 PER SHARE
(Title of Class)

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. X Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act) Yes No X

The aggregate market value of the Registrant's outstanding Common Stock held by non-affiliates of the Registrant at November 12, 2003, was approximately $1,977,000. There were 103,638,690 shares of Common Stock outstanding at November 12, 2003, and the closing sales price on our Common Stock was $0.02 on such date. Our Common Stock is an OTC security traded on the PINK.SHEETS under the symbol of ATSC.PK.

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PART I.

ITEM I. BUSINESS

OVERVIEW

We are a telecommunications provider, focusing on the carrier and network management services between the United States and Latin America. Our current operations involve services between the U.S. and Mexico. We provide carrier services to our customers utilizing VoIP gear, or Voice over Internet Protocol. We utilize this VoIP technology to transmit digital voice communication over the Internet and other leased data networks.

We have had operating losses for almost every quarter since we began operations in 1994. Our operating losses from continuing operations were approximately $4,850,000, $8,259,000 and $5,780,000, for the years ending July 31, 2001, 2002 and 2003, respectively. Additionally we had a working capital deficit of approximately $17,796,000, at July 31, 2003. We have experienced difficulty in paying our vendors and lenders on time in the past, and as a result on December 31, 2002 our carrier network capacity was idled and 27 US employees were terminated. This means that we were not able to generate revenues from carrier services during the second half of the fiscal year ending July 31, 2003. Revenues from carrer services accounted for approximately 91% of our overall revenues in fiscal 2001, 95% in fiscal 2002 and 94% in fiscal 2003.

During the fiscal year ending July 31, 2003 management continued to pursue different avenues for funding, through the issuance of debt or company stock. We were not successful during the year ended July 31, 2003 in raising the necessary capital to re-start our network, and as a result, two of our subsidiaries, ATSI (Texas), Inc. and TeleSpan, Inc., filed for protection under Chapter 11 of the U.S. Bankruptcy Code on February 4, 2003 and February 18, 2003 respectively. Additionally, the court ordered joint administration of both cases on April 9, 2003 and subsequently on May 14, 2003 the court converted the cases to Chapter 7. The two bankrupt subsidiaries were our two primary operating companies and they have ceased operations. These bankruptcies did not include the reporting entity (the SEC registrant)(the Company). As a result of the Chapter 7 bankruptcy of our two main operating subsidiaries, combined with the termination of all our US employees and the idling of the carrier network capacity, our ability to generate any revenue from our historical revenue generation sources was severely limited.

Due to the bankruptcies, recurring losses, as well as the negative cash flows generated from our operations and our substantial working capital deficit, the auditor's opinion on our financial statements as of July 31, 2003 calls attention to substantial doubts about our ability to continue as a going concern. This means that there is substantial doubt that we will be able to continue in business through the end of our next fiscal year, July 31, 2004. In order to remain a going concern, we intend to attract new customers and/or generate cash from debt or equity offerings. We cannot make any assurance that the Company will attain sufficient additional customers or funding to continue as a going concern. However, the Company's plan to remain a going concern is discussed in the following two paragraphs.

We intend to generate new customers. Subsequent to the year-ended July 31, 2003 we have signed agreements with three new carrier customers from which we have generated revenues of approximately $36,000 during the first quarter of fiscal year 2004. In addition, the Company has signed agreements with two communications companies, Telemarketing de Mexico S.A de C.V. (Telemarketing) and DialMex, LLC. ("DialMex"). Under the agreements with Telemarketing and DialMex, we will have access to their VoIP network and their different underlying carriers. These agreements will provide us the capacity to terminate and transport through their network approximately 80 million minutes on a monthly basis. Under our carrier service agreement with DialMex we will be invoiced weekly on a per minute rate basis and our termination cost will based on the destination of the call by our customers. We will be required to prepay for the estimated weekly usage based on estimated traffic from our customers. We believe that the lower network cost structure available under the agreements with DialMex will allow us to be more competitive, market our services to new customers and allow us to increase our revenue from the carrier services business.

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Additionally, we will combine our interconnection agreements with the major carriers in Mexico with the interconnection agreements between the carriers and DialMex to lower our termination costs and allow for a more attractive cost structure.

On July 02, 2003, the U.S. Bankruptcy Court overseeing the Chapter 7 cases for ATSI Texas and TeleSpan, Inc. approved the sale of two Mexican subsidiaries owned by ATSI Texas and TeleSpan, Inc. As a result, ATSI de Mexico S.A de C.V. (ATSI-Mexico) and Servicios de Infraestructura S.A de C.V. (SINFRA) were sold to Latingroup Ventures, L.L.C. (LGV), a non-related party. Under the purchase agreement LGV acquired all the communication centers and assumed all related liabilities associated with ATSI-Mexico and SINFRA. Additionally, under the agreement, LGV acquired the Comercializadora License held by ATSI-Mexico and the Teleport and Satellite Network License held by SINFRA. The Chapter 7 Bankruptcy Trustee received all the proceeds from the sale of these entities. Due to the sale of ATSI-Mexico and SINFRA, the Mexico-Telco segment, consisting primarily of retail call center operations, has been discontinued and in the future we will not able to generate revenues from retail services offered at the communication centers.

Our limited cash flow, historical losses from operations, the bankruptcies of our two main operating subsidiaries and sale of our retail services business have caused substantial barriers to growth and the continuation of our business strategy. Operationally, ATSI's strength lies in our interconnection agreements with carriers such as Telefonos de Mexico S.A de C.V. (Telmex) and Bestel S.A de C.V. and our 49% interest in ATSICOM, which owns a long distance concession license. Our interconnection agreements with these long-distance concessionaires provide us with nationwide network coverage at a competitive cost structure. Currently, Telmex owns and operates the only nationwide network in Mexico with more than 14.1 million phone lines in over 105,000 communities throughout Mexico. Bestel operates a fiber optic network that extends over 6,356 kilometers with points of presence in 19 Mexican metropolitan areas. Under these interconnection agreements the cost to the Company is based on a per minute rate and the volume of minutes transported through their respective networks. Additionally, we own 49% of a Mexican company, ATSI Comunicaciones, S.A. de C.V., that holds a 30 year concession, allowing for the sale of voice and data services, long distance transport, and the operation of a telecommunications network. Through interconnection agreements established by ATSI Comunicaciones, S.A de C.V. and our partnership with DialMex, LLC, we are able to utilize the networks of third parties in Mexico, such as Alestra and Marcatel to build a reliable international network to support carrier-generated traffic between the U.S. and Mexico.

HISTORY

We began operations in 1994 as a Canadian holding company, Latcomm International, Inc. with a Texas operating subsidiary, Latin America Telecomm, Inc. Both corporations were renamed "American TeleSource International, Inc." in

1994. In May 1998, the Canadian corporation completed a share exchange with a newly formed Delaware corporation, also called American TeleSource International, Inc., which resulted in the Canadian corporation becoming the wholly owned subsidiary of the Delaware corporation. In February 2001, our shareholders voted to change our name from American TeleSource International, Inc. to ATSI Communications, Inc.

Currently, our principal operating entity is:

- ATSI Communications Inc., a Delaware corporation, which was formed in 1996 and is the owner of 49% of ATSI Comunicaciones S.A de C.V., a Mexican corporation, that holds a 30 year concession, allowing for the sale of voice and data services, long distance transport, and the operation of a telecommunications network.

RECENT DEVELOPMENTS

During our fiscal year ending July 31, 2003, we announced that:

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- Effective January 31, 2003 Stephen M. Wagner resigned as President and Chief Executive Officer

- On December 31, 2002 our carrier network capacity was idled and 27 US employees were terminated.

- Two of our subsidiaries, ATSI (Texas), Inc. and TeleSpan, Inc., filed for protection under Chapter 11 of the U.S. Bankruptcy Code on February 4, 2003 and February 18, 2003 respectively. Additionally, the court ordered joint administration of both cases on April 9, 2003 and subsequently on May 14, 2003 the court converted the cases to Chapter 7.

- Effective April 30, 2003 J. Christopher Cuevas resigned as Interim CFO and on May 1, 2003 Raymond G. Romero resigned as Interim CEO. Additionally, we announced that Arthur L. Smith was appointed as CEO and Director and Antonio Estrada as the Corporate Controller.

- On May 22, 2003 we entered into a Share Purchase Agreement with Telemarketing de Mexico, S.A. de C.V. ("Telemarketing') whereby we sold Telemarketing 51% of our Mexican subsidiary, ATSI Comunicaciones, S.A. De C.V. ("ATSICOM").

- On July 02, 2003, the U.S. Bankruptcy Court overseeing the Chapter 7 cases for ATSI Texas and TeleSpan, Inc. approved the sale of two of its Mexican subsidiaries, ATSI-Mexico and SINFRA's to Latingroup Ventures, L.L.C. (LGV), a non-related party. Under the purchase agreement, LGV acquired all the communication centers and assumed all related liabilities of ATSI-Mexico and SINFRA. Additionally, under the agreement, LGV acquired the Comercializadora License owned by ATSI-Mexico and the Teleport and Satellite Network License owned by SINFRA. These entities were owned by our two subsidiaries ATSI (Texas) and TeleSpan, Inc. that filed for protection under Chapter 11 of the U.S. Bankruptcy Code in February 2003 and subsequently on May 14, 2003, were converted to Chapter 7 liquidation cases. Due to the bankruptcies and related sales of ATSI-Mexico and SINFRA we determined to discontinue the Mexico Telco operating segment, consisting primarily of retail call center operations.

SERVICES AND PRODUCTS

In the presentation of our historical financial results, we have divided our revenues into two categories: Carrier services and network services.

CARRIER SERVICES

We provide termination services to U.S. and Latin American telecommunications companies who lack transmission facilities, require additional capacity or do not have the regulatory licenses to terminate traffic in Mexico. Typically these telecommunications companies offer their services to the public for local and international long distance services. Revenues from this service accounted for approximately 91% of our overall revenues in fiscal 2001, 95% in fiscal 2002 and 94% in fiscal 2003. The percentage of our total volume of carrier services traffic sent by customers can fluctuate dramatically, on a quarterly, and sometimes, daily basis. Historically, a handful of customers have accounted for a majority of the total carrier services volume, although not necessarily the same customers. During fiscal year 2003, our agreements with customers were not for a specific period of time, but rather the customer was given a set rate for services and the customer would decide the volume of traffic it would send to us to terminate. Therefore on a month-to-month basis there was not a required volume commitment from them, so they were free to re-route their traffic away from us to a lower priced carrier.

During the year ended July 31, 2003, as the telecommunications sector has continued to suffer financially and operationally, we have seen a trend towards more and more of our carriers requiring substantial deposits and / or

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prepayments. Due to our limited resources and lack of a line of credit with our carriers, our carriers required prepayment and deposits to minimize their risk as they provide us with their services. During fiscal 2003 our carriers required deposits and prepayments equal to 25% or $600,000 of our weekly estimated traffic, this deposit requirements were calculated by our carriers using historical weekly traffic volumes and estimated future weekly traffic. As a result, of the substantial deposits and prepayment requirements and our lack of liquidity, in December 2002, we were forced to idle our network and we were not able to restart our network during the fiscal year ending July 31, 2003. We did not generate any revenue from this source during the second half of the fiscal year ending July 31, 2003. Subsequent to year-end we signed and carrier services agreement with DialMex. Under this agreement we are able to interconnect to DialMex's network and this has allowed us to be able to restart our carrier services network. We have signed three new carrier services customers and we have generated revenues of approximately $36,000 during the first quarter of fiscal year 2004. We were able to meet our prepayment requirements with DialMex by also requiring prepayments from our customers for weekly-expected traffic. However, there can be no assurance that we will continue to generate these levels of revenues from our customers in the future.

Going forward, the company will rely on the Share Purchase Agreement with Telemarketing de Mexico, S.A. de C.V. to continue to increase the carrier services business. Under the agreement entered on May 22, 2003, Telemarketing acquired 51% of our Mexican Subsidiary, ATSI Comunicaciones, S.A. de C.V. ("ATSICOM"). The principal owners of Telemarketing are also the principal owners of DialMex, LLC ("DialMex") a U.S. based international telecommunications carrier. We have entered a three-year service agreement with DialMex under which we will be allowed to use DialMex's VoIP network primarily to transport and terminate voice and fax communications over the Internet. Additionally, under the agreement with Telemarketing, we will enhance its network by linking DialMex's VoIP network with other carriers allowing us to reduce our transportation and termination costs, while simultaneously increasing and expanding our destination points available to our customers. Under the agreement with DialMex, we are invoiced weekly for transmission charges and termination charges and required to prepay for the estimated weekly usage based on estimated traffic from our customers. We believe that this lower network cost structure will allow the Company to be more competitive and attract more customers. Additionally, we will combine our respective interconnection agreements with the major carriers in Mexico, such as Telefonos de Mexico S.A de C.V. (Telmex) and Bestel S.A de C.V. As previously mentioned, our interconnection agreements with these long-distance concessionaires provide us with nationwide network coverage. Currently, Telmex owns and operates the only nationwide network in Mexico with more than 14.1 million phone lines in over 105,000 communities throughout Mexico. Bestel operates a fiber optic network that extends over 6,356 kilometers with points of presence in 19 Mexican metropolitan areas. In addition, the sale of 51% of ATSICOM to Telemarketing provides us with working capital while the agreement with DialMex will provide us with access to a reliable and flexible state-of-the-art VoIP network without incurring the expense of operating such a network. Due to the financial condition of the Company, there can be no assurance that the enhancements can be made or that the costs will be decreased or that we will be able to continue to make prepayments to DialMex.

NETWORK SERVICES

Private Network is a secure satellite communication connection or link between various remote locations. This connection is accomplished by having all of the various remote locations from one customer connected to a common satellite destination, were information is allowed to be exchange, transported and shared. We provide these services to multi-national and Latin American corporations or enterprise customers who use a high volume of telecommunications services to their U.S. offices or businesses and need greater dependability than is available through public networks. These services include the transportation of data, voice and fax transmission as well as Internet services between the customers multiple international offices and branches. Currently we do not have any network services customers; however, we provide network management services to Latingroup Ventures L.L.C.(LGV), a non-related party. Under the agreement with LGV we will provide customer service, technical support and manage the collections process of their private network customers. This management agreement was initiated on July 1, 2003 and we will generate approximately $12,700 per month in management fees. This management agreement will terminate on June 30, 2004.

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Currently we compete with MCI and Americatel, as well as the former telecommunication monopolies in the Latin American countries in providing network services. Factors contributing to our competitiveness include reliability, network quality, speed of installation, and in some cases, geography, network size, and hauling capacity. We are at a competitive disadvantage with respect to larger carriers who are able to provide networks for corporations that encompass more countries in Latin America, as well as Europe, Asia and other parts of the globe. As a result of these disadvantages we do not expect a significant increase in revenue from this source in the near future.

Currently we are also leasing satellite capacity and space segment on a month-to-month basis directly from Satellites Mexicanos, S.A. de C.V. (Satmex) for the connectivity for our network management customer. Under the month-to-month agreement we are currently incurring monthly fixed charges of approximately $6,300 for the space segment. Under the monthly agreement with Satmex we can increase or decrease capacity as the customer usage changes with demand. Additionally we can terminate this agreement at any time without any penalties from Satmex.

VOICE OVER INTERNET PROTOCOL NETWORKS

The basic technology of traditional telecommunications was designed for slow mechanical switches. Communications over the traditional telephone network are routed through circuits that must dedicate resources to each call from its inception until the call ends, regardless of whether anyone is actually talking on the circuit. This circuit-switching technology incurs a significant cost per call and does not efficiently support the integration of voice with data services. Data networks, however, were designed for electronic switching. They break the data stream into small, individually addressed packages of data ("packets") that are routed independently of each other from the origin to the destination. Therefore, they do not require a fixed amount of bandwidth to be reserved between the origin and destination of each call and they do not waste bandwidth when it is not being used for actual transmission of information. This allows multiple voice or voice and data calls to be pooled, resulting in these networks being able to carry more calls with an equal amount of bandwidth. Moreover, they do not require the same complex switching methods required by traditional voice telephone networks, instead using a multiplicity of routers to direct each packet in the direction of its destination and they automatically route packets around blockages, congestion or outages.

Packet switching is a method of transmitting messages that can be used within a data network or across networks, including the public Internet. The Internet itself is not a single data network owned by any single entity, but rather a loose interconnection of networks belonging to many owners that communicate using the Internet Protocol (IP). By converting voice signals to digital data and handling the voice signals as data, it can be transmitted through the more efficient switching networks designed for data transmissions and through the Internet using the IP. The transmission of voice signals as digitalized data streams over the Internet is known as Voice over Internet Protocol or VoIP. The following are the advantages of using VoIP compared to traditional networks:

- INTEGRATION OF VOICE AND DATA: VoIP networks allows for the integration of voice, data traffic and images into the same network.

- SIMPLIFICATION: An integrated infra structure that supports all forms of communication allows more standardization and less equipment management. The result is a fault tolerant design.

- NETWORK EFFICIENCY: The integration of voice and data fills up the data communication channels efficiently, thus providing bandwidth consolidation and reduction of the costs associated with idle band-with. The sharing of equipment and operations costs across both data and voice users can also improve network efficiency since excess bandwidth on one network can be used by the other, thereby creating economies of scale for voice (especially given the rapid growth in data traffic). An integrated infrastructure that supports all forms of communication allows more standardization and reduces the total equipment complement. This combined infrastructure can support dynamic bandwidth optimization and a fault

tolerant design. The differences between the traffic patterns of voice and data offer further opportunities for significant efficiency improvements.

- CO-EXISTENCE WITH TRADITIONAL COMMUNICATION MEDIUMS: The final advantage of VoIP is that it is additive to today's communications networks. IP telephony can be used in conjunction with existing PSTN switches, leased and dial-up lines, PBXs and other customer premise equipment (CPE), enterprise LANs, and Internet connections. IP telephony applications can be implemented through dedicated gateways, which in turn can be based on open standards platforms for reliability and scalability.

- COST REDUCTION: Under the VoIP network, the connection is directly to the Internet backbone and as a result the telephony access charges and settlement fees are avoided.

The growth of voice on the Internet was limited in the past due to poor sound quality caused by technical issues such as delays in packet transmission and by bandwidth limitations related to Internet network capacity and local access constraints. However, the continuing addition of data network infrastructure, recent improvements in packet switching and compression technology, new software algorithms and improved hardware have substantially reduced delays in packet transmissions and the effect of these delays. Nevertheless, certain VoIP routes into countries with limited or poor Internet infrastructure continue to lack the consistent quality required for voice transport and termination.

A number of large long distance carriers have announced Internet telephony service offerings. Smaller Internet telephony service providers have also begun to offer low-cost Internet telephony services from personal computers to telephones and from telephones to telephones. Traditional carriers have substantial investments in traditional telephone network technology, and therefore have been slow to embrace Internet technology.

We believe that the infrastructure required for a global network is too expensive for most companies to deploy on their own. This mandates that the network be a combination of gateways owned by different operators. For a network to achieve optimal functionality and quality, however, the gateways need to be interoperable, or able to communicate with one another. Interoperability continues to be a challenge for VoIP providers and recently, technological solutions have emerged that support interoperability between different protocols and/or gateways. Cisco appears to have emerged as a dominant supplier of VoIP gateways and other manufacturers often seek to make their equipment interoperable with Cisco.

Long distance telephone calls transported over the Internet are less expensive than similar calls carried over the traditional telephone network primarily because the cost of using the Internet is not determined by the distance those calls need to travel. Also, routing calls over the Internet is more cost-effective than routing calls over the traditional telephone network because the technology that enables Internet telephony is more efficient than traditional telephone network technology. The greater efficiency of the Internet creates cost savings that can be passed on to the consumer in the form of lower long distance rates or retained by the carrier as higher margins.

By using the public Internet, VoIP providers like ATSI are able to avoid direct payment for transport of communications, instead paying for large "pipes" into the public Internet, billed by bandwidth rather than usage, which transmits calls to a distant gateway. The Internet, which has its origins in programs devised by the Department of Defense to provide multiple routes and therefore redundancy which was largely immune from the failure of a single network element, provides great redundancy and can be "self healing" in the event of an outage in a particular network element or transmission path. Moreover, adding an additional entry or exit point (a Point of Presence or "PoP") does not require any expensive or time consuming reconfiguration or reprogramming of existing network elements. The new element is simply installed with a specific

IP address and it can send or receive information from any other IP address on the Internet."

STRATEGY AND COMPETITIVE CONDITIONS

The long distance telephony market and the Internet telephony market are highly competitive. There are several large and numerous small competitors, and we expect to face continuing competition based on price and service offerings from existing competitors and new market entrants in the future. The principal competitive factors in our market include price, quality of service, coverage, customer service, reliability, and network size/capacity. Our competitors include major and emerging telecommunications carriers in the U.S. and foreign telecommunications carriers. The financial difficulties of many telecommunications providers are rapidly altering the number, identity and competitiveness of the marketplace, and we are unable to determine with certainty the eventual result of the consolidation occurring in our industry.

During the past several years, a number of companies have introduced services that make Internet telephony or voice services over the Internet available to other carriers. All major telecommunications companies either presently or could potentially route traffic to destinations worldwide and compete or can compete directly with us. Other Internet telephony service providers focus on a retail customer base and may in the future compete with us in the carrier services business. In addition, companies currently in related markets have begun to provide voice over the Internet services or adapt their products to enable voice over the Internet services. These related companies may potentially migrate into the Internet telephony market as direct competitors.

Carriers buying wholesale termination into Mexico, while cost conscious, are increasingly demanding high reliability and quality in service delivery. Sustainability and growth in this segment depends on specific competitive advantages that companies may possess in specific markets. Competitive advantages like proper licenses, network redundancy, favorable termination agreements, or the presence of a business infrastructure and relationships in the specific terminating market. The Company competes with the dominant providers, such as Qwest and MCI, as well as other, smaller providers for international long distance services to Mexico. The Company believes that in contrast to the dominant providers, it has a much more focused and cost competitive strategy that targets selected higher margin telecommunications niches. Certain carriers provide termination services in Mexico at lower prices (e.g., $0.03 to $0.07) because they contract with other carriers that "leak" into the local network using unlicensed IP points of presence. These carriers, however, have several disadvantages including: (i) generally poor quality, (ii) limited capacity, and (iii) poor reliability, since Mexican authorities periodically shut down their operations. Additionally, there are a few market trends that affect our wholesale product's competitiveness in the market. First, unauthorized, non-conventional operators continue to have a major impact by offering prices below real costs. Second, reduced settlement rates in Mexico continue to drive down costs. The result of this trend is a significant reduction in revenue per minute. The combination of non-conventional termination and the new settlement rates have reduced U.S to Mexico termination prices from an average price of $0.27 per minute in 1998 to a current $0.045 per minute.

Many of our competitors have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, greater name recognition and more established relationships in the industry than we have. As a result, certain of these competitors may be able to adopt more aggressive pricing policies that could hinder our ability to market our services. We believe that our key competitive advantages are our ability to deliver reliable, high quality voice service over the Internet in a cost-effective manner. We cannot provide assurances, however, that these advantages will enable us to succeed against comparable service offerings from our competitors. A large number of telecommunications companies, including AT&T, WorldCom, Qwest and Sprint currently provide wholesale voice telecommunications service which competes with our business. These companies, which tend to be large entities with substantial resources, generally have large budgets available for research and development, and therefore may further enhance the quality and acceptance of the transmission of voice over the Internet.

Our strategy is to position ourselves to take advantage of the demonopolization of the Latin American telecommunications markets, as well as the increasing demand for international communications services between these markets and the United States. Historically, telecommunications services in Latin America have been provided

by state-run companies, operating as a legal or de facto monopoly. Although these companies failed to satisfy the demand for services in their countries, the regulatory scheme effectively precluded competition by foreign carriers. Currently, there is a trend toward demonopolization of the telecommunications industry in Latin America, and many of these countries are in various stages of migration toward a competitive, multi-carrier market. Many Latin American countries produce a significant number of immigrants to the United States, or are becoming homes to U.S. based corporations seeking lower labor costs. At the same time that Latin American markets have been opening up, the demand for telecommunications services between the United States and Latin America (particularly Mexico) has been strengthened by:

- the rapid growth of the Latino segment of the United States population
- Mexico's status as the top calling partner with the United States
- increase in trade and travel between Latin America and the United States
- the build-out of local networks and corresponding increase in the number of telephones in homes and businesses in Latin countries
- proliferation of communications devices such as faxes, mobile phones, pagers, and personal computers
- declining rates for services as a result of increased competition.

Our strengths include our knowledge of, and relationships within, the telecommunications industry in the United States and certain countries within Latin America, particularly Mexico. Our management and employees have in-depth knowledge of the Mexican culture, business environment and telecommunications industry. As a result, we have been able to obtain a key long distance concession through our 49% ownership in ATSI Comunicaciones S.A de C.V. (ATSICOM) that allows us to both generate and carry traffic within Mexico and between Mexico and the United States. Technological advances have provided emerging carriers with the means to provide high quality transmission on a cost-effective basis. Most notably, we as well as other emerging carriers now use voice over Internet protocol or VoIP technology, which is a method of transmitting voice communications by breaking the information into data packets and transporting them over the Internet. Under our agreement with DialMex, LLC, ATSI is utilizing a low-cost VoIP network in Mexico previously deployed by DialMex. We have focused most of our efforts on Mexico. As regulatory and market conditions permit, we would like to provide services in other Latin American countries.

Telefonos de Mexico S.A de C.V.(or Telmex) had a legal franchise to control the entire market for local and long distance telecommunications in Mexico until June of 1995, when new laws began to open the market to competition. This means that Telmex owned or controlled all of the physical infrastructure needed to transport telecommunications traffic, including the local network of telephone lines to homes and business in a given area, and the long distance network of lines between the local networks. In January 1997, the Mexican government began granting licenses to provide long distance service to competing companies, and has licensed at least 29 new long distance providers. Two of these license holders are Mexican based affiliates of top tier U.S. carriers MCI and AT&T. Although the Mexican government has also licensed additional local competitors, the build out of additional local infrastructure is just beginning, and the local network in Mexico is still dominated by Telmex. In 1994 we began assembling a framework of licenses, reciprocal services agreements with other carriers, other service agreements, network facilities, and distribution channels in Mexico in anticipation of the demonopolization of this market. During the same year we also began providing private network services between the U.S. and Mexico via satellite. In fiscal year 2000 we secured our own long distance license, which permits us to interconnect directly with the local network and build out our own long distance network, further reducing our costs. In May 2003, we sold 51% of our subsidiary that owns a long distance concession in Mexico, ATSI Comunicaciones, S.A. de C.V. to a group of Mexican investors, Telemarketing S.A de C.V. and secured an agreement with the same group to utilize their VoIP network for transporting services to, from, and within Mexico. We believe that our long distance concession and partnership with the Mexican investment group will position us to take advantage of the benefits to be reaped as the Mexican telecommunications industry continues to evolve and creates opportunities for emerging carriers. We believe that we have a clear competitive advantage over non-licensed resellers, and that we have overcome significant hurdles that are

a barrier to entry in this market even for large carriers. We intend to use our license and partnership to capture increased amounts of the communications traffic in the Mexican market.

LICENSES/REGULATORY

Our operations are subject to federal, state and foreign laws and regulations.

Federal

Pursuant to Section 214 of the Communications Act of 1934, the Federal Communications Commission ("FCC") has granted us global authority to provide switched international telecommunications services between the U.S. and certain other countries. We maintain informational tariffs on file with the FCC for our international retail rates and charges.

The Telecommunications Act of 1996, which became law in February 1996, was designed to dismantle the monopoly system and promote competition in all aspects of telecommunications. The FCC has promulgated and continues to promulgate major changes to their telecommunications regulations. One aspect of the Telecom Act that is of particular importance to us is that it allows Bell Operating Companies or BOCs to offer in-region long distance service once they have taken certain steps to open their local service monopoly to competition. Given their extensive resources and established customer bases, the entry of the BOCs into the long distance market, specifically the international market, will create increased competition for us. Southwestern Bell's application to offer in region long distance was approved in June 2000.

Although we do not know of any other specific new or proposed regulations that will affect our business directly, the regulatory scheme for competitive telecommunications market is still evolving and there could be unanticipated changes in the competitive environment for communications in general. For example, the FCC is currently considering rules that govern how Internet providers share telephone lines with local telephone companies and compensate local telephone companies. These rules could affect the role that the Internet ultimately plays in the telecommunications market.

The International Settlements Policy governs settlements between top tier U.S. carriers' and foreign carriers' costs of terminating traffic over each other's networks. The FCC recently enacted certain changes in our rules designed to allow U.S. carriers to propose methods to pay for international call termination that deviate from traditional accounting rates and the International Settlement Policy. The FCC has also established lower benchmarks for the rates that U.S. carriers can pay foreign carriers for the termination of international services and these benchmarks may continue to decline. These rule changes have lowered the costs of our top tier competitors to terminate traffic in the United States and are contributing to the substantial downward pricing pressure facing us in the carrier market. And as a result of these substantial downward pricing pressures we have been forced to significantly reduce our terminations rates to our customers to match the termination rates offered by our competitors in order to be competitive, retain and attract new customers. Additionally, as a result of the reduction in our termination rates to our customers our margins have diminished by approximately 1-2%.

State

Many states require telecommunications providers operating within the state to maintain certificates and tariffs with the state regulatory agencies, and to meet various other requirements (e.g. reporting, consumer protection, notification of corporate events). We believe we are in compliance with all applicable State laws and regulations governing our services.

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Mexico

The Secretaria de Comunicaciones y Transportes or the SCT and COFETEL (Comision Federal de Telecomunicaciones or Federal Telecommunications Commission) have issued ATSICOM a 30-year license granted in June 1998 to install and operate a public network. Under this license, ATSI Comunicaciones de Mexico S.A de C.V. is required to meet the following:

General requirements

- Maintain approximately 10 millions dollars in registered and subscribed capital
- Install and operate a network in Mexico, the Mexican government will need to approve the operating plan before is implemented, additionally the Mexican government will need to approve any future changes to the operating plan before it can be implemented.
- Continuously develop and conduct training programs for its staff
- The Concessionaire, at all times needs to have an assigned individual responsible for the technical functions to operate the concession.

Concession services requirements

- The Concessionaire is required to provide continuous and efficient services at all times to its customers.
- The Concessionaire must establish a complaint center and correction facilities center. We are required to report to the Mexican Government on a monthly basis the complaints received and the actions taken to resolve the problems.

Tariff Requirements

- The Concessionaire will only be authorized to invoice its customer's tariffs rates that have been approved by the Mexican government.

Verification and Information requirements

- The Concessionaire is required to provide audited financial statements on a yearly basis that includes a detailed description of the fixed assets utilized in the network and accounting reporting by region and location of where the services are being provided.
- The Concessionaire is required to provide quarterly reports and updates on the expansion of the network in Mexico and a description of the training programs and research and development programs.
- The Concessionaire is required to provide statistic reports of traffic, switching capacity and other parameters in the network.

Guarantee requirements

The Concessionaire is required to have a bond/ insurance policy for approximately $500,000 dollars, where the Mexican Federal Treasury Department will be the beneficiary in the event the Mexican government revokes the concession license.

SUPPLIERS

We rely on various suppliers to provide services in connection with our communication services. SATMEX provides us with network management services in connection with our network. We also depend on various U.S. long

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distance companies to complete the intra-U.S. portion and on various Mexican long distance companies to complete the intra-Mexico portion of our voice transmissions. Other critical suppliers include TelMex, Bestel, DialMex and Advance Global Communications.

EMPLOYEES

As of July 31, 2003, we had 4 employees, all of whom performed operational, technical and administrative functions.

We believe our future success will depend to a large extent on our continued ability to attract and retain highly skilled and qualified employees. We consider our employee relations to be good. None of these aforementioned employees belong to labor unions.

ADDITIONAL RISK FACTORS

The purchase of our common stock is very risky. You should not invest any money that you cannot afford to lose. Before you buy our stock, you should carefully read all of our periodic reports, including our 10-Q's and the entire Form 10-K.

RISKS RELATED TO OPERATIONS

- OUR AUDITORS HAVE QUESTIONED OUR VIABILITY

  Our auditors' opinion on our financial statements as of July 31, 2003 calls attention to substantial doubts as to our ability to continue as a going concern. This means that they question whether we can continue in business. If we cannot continue in business, our common stockholders would likely lose their entire investment. Our financial statements are prepared on the assumption that we will continue in business. They do not contain any adjustments to reflect the uncertainty over our continuing in business.

- WE EXPECT TO INCUR LOSSES, SO IF WE DO NOT RAISE ADDITIONAL CAPITAL WE MAY GO OUT OF BUSINESS

  We have never been profitable and may not become profitable in the near future. We will continue to invest money in sales and marketing and personnel in order to maintain and develop the customer base we need to achieve profitability. Our investment may not generate the savings and revenues that we anticipate because of a variety of factors, such as:

  - delays in negotiating acceptable interconnection agreements with Telmex, the former monopoly carrier in Mexico; and
  - operational delays caused by our inability to obtain additional financing in a timely fashion.

  In the past we have financed our operations almost exclusively through the private sales of securities. Since we are losing money, we must raise the money we need to continue operations either by selling more securities or borrowing money. We are not currently able to sell additional securities or borrow money on terms as desirable as those available to profitable companies, and may not be able to raise money on any acceptable terms. If we are not able to raise additional money, we will not be able to implement our strategy for the future, and we will either have to scale back our operations or stop operations.

  During fiscal year ended July 31, 2003 our two primary operating subsidiaries, ATSI (Texas), Inc. and TeleSpan, Inc., filed for protection under Chapter 11 of the U.S. Bankruptcy Code on February 4, 2003 and February 18, 2003 respectively. Additionally, the court ordered joint administration of both cases on April 9, 2003 and

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subsequently on May 14, 2003 the court converted the cases to Chapter 7. These subsidiaries have terminated all operations. And the Bankruptcy is managing the liquidation process of all the assets held by these entities.

- IT IS DIFFICULT FOR US TO COMPETE WITH MUCH LARGER COMPANIES SUCH AS AT&T, SPRINT, MCI AND TELMEX

The large carriers such as AT&T, Sprint and MCI in the U.S., and Telmex in Mexico, have more financial resources and extensive owned networks than we do, which enables them to control costs more easily than we can. They are also able to take advantage of their large customer base to generate economies of scale, substantially lowering their per-call costs. Therefore, they are better able than we are to lower their prices as needed to retain customers; additionally they are better able to offer flexible payment terms to their customers. In addition, these companies have stronger name recognition and brand loyalty, as well as a broader portfolio of services, making it difficult for us to attract new customers. Our competitive strategy in the U.S. revolves around targeting markets that are largely underserved by the big carriers. However, some larger companies are beginning efforts or have announced that they plan to begin efforts to capture these markets.

Mergers, acquisitions and joint ventures in our industry have created and may continue to create more large and well-positioned competitors. These mergers, acquisitions and joint ventures could increase competition and reduce the number of customers that purchase carrier service from us.

- COMPETITION COULD HARM US

International telecommunications providers like us compete based on price, customer service, transmission quality and breadth of service offerings. Many of our larger competitors enjoy economies of scale that can result in lower termination and network costs. This could cause significant pricing pressures within the international communications industry. In recent years, prices for international and other telecommunications services have decreased as competition continues to increase in most of the markets in which we currently compete or intend to compete. If these pricing pressures continue, we must continue to lower our costs in order to maintain sufficient profits to continue in this market. We believe competition will intensify as new entrants increase as a result of the new competitive opportunities created by the Telecommunications Act of 1996, implementation by the Federal Communications Commission of the United States' commitment to the World Trade Organization, and privatization, deregulation and changes in legislation and regulation in many of our foreign target markets. We cannot assure you that we will be able to compete successfully in the future, or that such intense competition will not have a material adverse effect on our business, financial condition and results of operations.

- COMPETITION IN MEXICO IS INCREASING

Mexican regulatory authorities have granted concessions to at least 30 companies, including Telmex, to construct and operate public, long distance telecommunications networks in Mexico. Some of these new competitive entrants have as their partners major U.S. telecommunications providers including AT&T (Alestra) and MCI (Avantel) Mexican regulatory authorities have also granted concessions to provide local exchange services to several telecommunications providers, including Telmex and Red de Servicios de Telecomunicaciones, S.A. de C.V., Megacable Comunicaciones de Mexico and several of Mexico's long distance concessionaires. We compete or will compete to provide services in Mexico with numerous other systems integration, value-added and voice and data services providers, some of which focus their efforts on the same customers we target. In addition to these competitors, recent and pending deregulation in Mexico may encourage new entrants.

Moreover, while the WTO Agreement could create opportunities to enter new foreign markets, the United States' and other countries' implementation of the WTO Agreement could result in new competition from operators previously banned or limited from providing services in the United States. This could result in increased competition, which could materially and adversely affect our business, financial condition and results of operations.

- OUR MEXICAN FACILITIES-BASED LICENSE POSES RISKS

Currently we own 49% of ATSICOM that holds the Concession . This license is for 30 years, and it can be renewed at the end of the term. This concession is the major asset of the company and is regulated by the Mexican government. The Mexican government could grant similar concessions to our competitors, which will affect the value of our concession. In addition, the Mexican government also has (1) authority to temporarily seize all assets related to the Mexican concession in the event of natural disaster, war, significant public disturbance and threats to internal peace and for other reasons of economic or public order and (2) the statutory right to expropriate any concession and claim all related assets for public interest reasons. Although Mexican law provides for compensation in connection with losses and damages related to temporary seizure or expropriation, we cannot assure you that the compensation will be adequate or timely.

In addition, the concession requires us to meet a number of financial and operational requirements, and to invest in the installation of a communications network in Mexico. If our partners or we fail to comply with the terms of the concession, the Mexican government may terminate it without compensation to our partners or us. A termination would prevent us from engaging in our proposed business.

- THE TELECOMMUNICATIONS INDUSTRY HAS BEEN CHARACTERIZED BY STEADY TECHNOLOGICAL CHANGE. WE MAY NOT BE ABLE TO RAISE THE MONEY WE NEED TO ACQUIRE THE NEW TECHNOLOGY NECESSARY TO KEEP OUR SERVICES COMPETITIVE.

To complete successfully in the carrier and network services markets, we must maintain the highest quality of service. Therefore we must continually rely on our partners, DialMex and Telemarketing to upgrade their network to keep pace with technological changes. This is expensive, and our partners, DialMex and Telemarketing do not have substantial resources that our large competitors have.

- WE MAY NOT BE ABLE TO PAY OUR SUPPLIERS ON TIME, CAUSING THEM TO DISCONTINUE CRITICAL SERVICES

Historically, we have not always paid all of our suppliers on time due to temporary cash shortfalls. Critical carriers and suppliers may discontinue our services, if we are not able to make payments on time in the future. Our ability to make payments on time depends on our ability to raise additional capital or improve our cash flow from operations.

- WE MAY NOT BE ABLE TO LEASE TRANSMISSION FACILITIES WE NEED AT COST-EFFECTIVE RATES

We do not own any transmission facilities needed to complete our calls. Therefore, we depend on contractual arrangements with other telecommunications companies to provide our services. We do not own any VoIP network, switching network and the equipment required to receive and transmit calls; we depend on our carriers for these services and our carrier service agreement with our partners, Telemarketing and DialMex. Our carriers' and partners' might not be able to lease facilities at cost-effective rates in the future or enter into contractual arrangements necessary for us to provide competitive services to our carrier customers.

- THE CARRIERS ON WHOM WE RELY FOR INTRA-MEXICO LONG DISTANCE MAY NOT STAY IN BUSINESS LEAVING US FEWER AND MORE EXPENSIVE OPTIONS TO COMPLETE CALLS

There are only 30-licensed Mexican long distance companies. Through our partners and our Concession license we currently have agreements with five of them. If the number of carriers who provide intra-Mexico long distance is reduced, we will have fewer route choices and may have to pay more for this service.

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- WE MAY HAVE SERVICE INTERRUPTIONS AND PROBLEMS WITH THE QUALITY OF TRANSMISSION, CAUSING US TO LOSE CALL VOLUME AND CUSTOMERS

To retain and attract customers, we must keep our services operational 24 hours per day, 365 days per year. We have experienced service interruptions and other problems that affect the quality of voice and data transmission. We may experience more serious problems. In addition to the normal risks that any telecommunications company faces (such as fire, flood, power failure, equipment failure), we may have a serious problem if a meteor or space debris strikes the satellite that transmits our traffic, or a volcanic eruption or earthquake interferes with our operations in Mexico City. If a portion of our suppliers network is effected by such an event, a significant amount of time could pass before we could re-route traffic from one carrier to another, and there may not be sufficient capacity to carry all the traffic at any given time.

- CHANGES IN TELECOMMUNICATIONS REGULATIONS MAY HARM OUR COMPETITIVE POSITION

Historically, telecommunications in the U.S. and Mexico have been closely regulated under a monopoly system. As a result of the Telecommunications Act of 1996 in the U.S. and new Mexican laws enacted in the 1990's, the telecommunications industry in the U.S. and Mexico are in the process of a revolutionary change to a fully competitive system. U.S. and Mexican regulations governing competition are evolving as the market evolves. For example, FCC regulations now permit the regional Bell operating companies (former local telephone monopolies such as Southwestern Bell) to enter the long distance market if certain conditions are met. The entry of these formidable competitors into the long distance market will make it more difficult for us to establish a consumer customer base. There may be significant regulatory changes that we cannot even predict at this time. We cannot be sure that the governments of the U.S. and Mexico will even continue to support a migration toward a competitive telecommunications market.

- REGULATORS MAY CHALLENGE OUR COMPLIANCE WITH LAWS AND REGULATIONS CAUSING US CONSIDERABLE EXPENSE AND POSSIBLY LEADING TO A TEMPORARY OR PERMANENT SHUT DOWN OF SOME OPERATIONS

Government enforcement and interpretation of the telecommunications laws and licenses is unpredictable and is often based on informal views of government officials and ministries. This is particularly true in Mexico and certain of our target Latin American markets, where government officials and ministries may be subject to influence by the former telecommunications monopoly, such as Telmex. This means that our compliance with the laws may be challenged. It could be very expensive to defend this type of challenge and we might not win. If we were found to have violated the laws that govern our business, we could be fined or denied the right to offer services.

- OUR OPERATIONS MAY BE AFFECTED BY POLITICAL CHANGES IN MEXICO AND OTHER LATIN AMERICAN COUNTRIES

The majority of our foreign operations are in Mexico. The political and economic climate in Mexico is more uncertain than in the United States and unfavorable changes could have a direct impact on our operations in Mexico. The Mexican government exercises significant influence over many aspects of the Mexican economy. For example, a newly elected set of government officials could decide to quickly reverse the deregulation of the Mexican telecommunications industry economy and take steps such as seizing our property, revoking our licenses, or modifying our contracts with Mexican suppliers. A period of poor economic performance could reduce the demand for our services in Mexico. There might be trade disputes between the United States and Mexico that result in trade barriers such as additional taxes on our services. The Mexican government might also decide to restrict the conversion of pesos into dollars or restrict the transfer of dollars out of Mexico. These types of changes, whether they occur or are only threatened, could have a material adverse effect on our results of operations and would also make it more difficult for us to obtain financing in the United States.

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RISKS RELATED TO FINANCING

- THE TERMS OF OUR PREFERRED STOCK INCLUDE DISINCENTIVES TO A MERGER OR OTHER CHANGE OF CONTROL, WHICH COULD DISCOURAGE A TRANSACTION THAT WOULD OTHERWISE BE IN THE INTEREST OF OUR STOCKHOLDERS

  In the event of a change of control of ATSI, the terms of the Series D Preferred Stock permit the holder to choose either to receive whatever cash or stock the common stockholders receive in the change of control transaction as if the Series D stock Preferred Stock had been converted, or to require us to redeem the Series D Preferred Stock at $1,560 per share. If all 742 shares currently outstanding were outstanding at the time of a change of control, this could result in a payment to the holder of approximately $1.2 million. The possibility that we might have to pay this large amount of cash would make it more difficult for us to agree to a merger or other opportunity that might arise even though it would otherwise be in the best interest of the stockholders.

- WE MAY HAVE TO REDEEM THE SERIES D AND SERIES E PREFERRED STOCK FOR A SUBSTANTIAL AMOUNT OF CASH, WHICH WOULD SEVERELY RESTRICT THE AMOUNT OF CASH AVAILABLE FOR OUR OPERATIONS.

  The terms of the Series D Preferred Stock require us to redeem the stock for cash in two circumstances in addition to the change of control situation described in the immediately preceding risk factor.

  First, the terms of the Series D Preferred Stock prohibit the holder from acquiring more than 11,509,944 shares of our common stock, which is 20% of the amount of shares of common stock outstanding at the time we issued the Series D Preferred Stock. The terms of the Series D Preferred Stock also prohibit the holder from holding more than 5% of our common stock at any given time. Due to the floating conversion rate, the number of shares of common stock that may be issued on the conversion of the Series D Preferred Stock increases as the price of our common stock decreases, so we do not know the actual number of shares of common stock that the Series D Preferred Stock will be convertible into.

  Second, if we refuse to honor a conversion notice or a third party challenges our right to honor a conversion notice by filing a lawsuit, the holder may require us to redeem any shares it then holds for $1,270 per share. If all 742 shares currently outstanding were outstanding at the time of redemption, this would result in a cash payment of approximately

$942,000 plus accrued and unpaid dividends. If we were required to make cash payment of this size, it would severely restrict our ability to fund our operations. On January 24, 2003 we received a redemption letter from the Series D holder requesting that we redeem all of their outstanding shares. As of the date of this filing no common stock has been issued to satisfy this demand. However, we have adjusted the Series D Preferred Stock to the full redemption amount of approximately $942,000 by recording a dividend of approximately $284,000. In addition the redemption amount was reclassed to accrued liabilities. It is the position of the Company that no additional investor shares are owed; further the Company has filed a lawsuit against one or more parties to whom the alleged additional shares are owed. We are currently seeking damages from these parties.

Similarly, the Series E Preferred Stock requires mandatory redemption if (a) we fail to: issue shares of common stock upon conversion, remove legends on certificates representing shares of common stock issued upon conversion or to fulfill certain covenants set forth in the Securities Purchase Agreement between ATSI and the holders of the Series E Preferred Stock; (b) we fail to obtain effectiveness of the registration statement covering the shares of common stock to be issued upon the conversion of the Series E Preferred Stock prior to March 11, 2001; (c) certain bankruptcy and similar events occur; (d) we fail to maintain the listing of the common stock on the Nasdaq National Market, the Nasdaq Small Cap Market, the AMEX or the NYSE; or (e) our long distance concession license from the Republic of Mexico is terminated or limited in scope by any regulatory authorities. The Redemption Price equals the greater of (x) 125% of the stated value ($1,000) plus 6% per annum of the stated value plus any conversion default payments due and owing by ATSI and (y) the product of (i) the highest number

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of shares of common stock issuable upon conversion times (ii) the highest closing price for the common stock during the period beginning on the date of first occurrence of the mandatory redemption event and ending one day prior to the date of redemption minus the amount of money we receive upon the exercise of the investment options provided in the Series E Preferred Stock which, upon conversion allows the holders to purchase an additional 0.8 share of ATSI common stock for each share of ATSI common stock received upon conversion. While we have not received a formal demand letter from the holder of the Series E Preferred Stock requesting redemption we have received conversion notices for which we have not issued common stock. However, during the fiscal year 2003, the additional "beneficial conversion feature" of approximately $292,500 related to the remaining 1,170 Series E Preferred Stock was allocated to additional paid-in capital as a discount.

- WE MAY REDEEM OUR PREFERRED STOCK ONLY UNDER CERTAIN CIRCUMSTANCES, AND REDEMPTION REQUIRES US TO PAY A SIGNIFICANT AMOUNT OF CASH AND ISSUE ADDITIONAL WARRANTS; THEREFORE WE ARE LIMITED AS TO WHAT STEPS WE MAY TAKE TO PREVENT FURTHER DILUTION TO THE COMMON STOCK IF WE FIND ALTERNATIVE FORMS OF FINANCING

We may redeem the Series A Preferred Stock only after the first anniversary of the issue date, and only if the market price for our common stock is 200% or more of the conversion price for the Series A Preferred Stock. The redemption price for the Series A stock is $100 per share plus accrued and unpaid dividends. We may redeem the Series D Preferred Stock only if the price of our common stock falls below $9.00, the price on the date of closing the Series D Preferred Stock. The redemption price is $1,270 per share, plus accrued but unpaid dividends, plus an additional warrant for the purchase of 150,000 shares of common stock at a price of $4.37 per share. Subject to certain conditions, we have the right to redeem the Series E Preferred Stock if, at any time after October 11, 2001, on any trading day and for a period of 20 consecutive trading days prior thereto, the closing bid price is less than $1.24. In the event that we are able to find replacement financing that does not require dilution of the common stock, these restrictions would make it difficult for us to "refinance" the preferred stock and prevent dilution to the common stock.

RISKS RELATING TO MARKET FOR OUR COMMON STOCK

- OUR COMMON STOCK WAS DELISTED FROM AMEX

  The company was de-listed from AMEX on April 24, 2003 and currently we are trading our common stock as an Over The Counter (OTC) security on the pink sheets, which is regulated by the NASD. This has adversely affected the liquidity of the common stock because it is more difficult for stockholders to obtain accurate stock quotations. In addition, since our stock is currently not being traded on a national exchange, sales of our stock would likely be subject to the SEC's penny stock rules, which generally create a delay between the time that a stockholder decides to sell shares and the time that the sale may be completed.

- THE PRICE OF OUR COMMON STOCK HAS BEEN VOLATILE AND COULD CONTINUE TO FLUCTUATE SUBSTANTIALLY

  Our common stock is traded on the pink sheets and is regulated by the NASD. The market price of our common stock has been volatile and could fluctuate substantially based on a variety of factors, including the following:

  - announcements of new products or technologies innovations by us or others;
  - variations in our results of operations;
  - the gain or loss of significant customers;
  - the timing of acquisitions of businesses or technology licenses;
  - legislative or regulatory changes;
  - general trends in the industry;
  - market conditions; and
  - analysts' estimates and other events in our industry.

- FUTURE SALES OF OUR COMMON STOCK IN THE PUBLIC MARKET COULD LOWER OUR STOCK PRICE

  Future sales of our common stock in the public market could lower our stock price and impair our ability to raise funds in new stock offerings. As of July 31, 2003, we had 103,638,690 shares of common stock outstanding and 8,673,659 shares issuable upon exercise of outstanding options and warrants. In addition, we have shares which could be issued upon conversion of our outstanding Series A, D and E, F and G Preferred Stock (subject to adjustment). Additionally, we may issue a significant number of additional shares of common stock as consideration for acquisitions or other investments as well as for working capital. Sales of a substantial amount of common stock in the public market, or the perception that these sales may occur, could adversely affect the market price of our common stock prevailing from time to time in the public market and could impair our ability to raise funds in additional stock offerings.

- WE WILL LIKELY CONTINUE TO ISSUE COMMON STOCK OR SECURITIES CONVERTIBLE INTO COMMON STOCK TO RAISE FUNDS WE NEED, WHICH WILL FURTHER DILUTE YOUR OWNERSHIP OF ATSI AND MAY PUT ADDITIONAL DOWNWARD PRICING PRESSURE ON THE

COMMON STOCK

Since we continue to operate at a cash flow deficit, we will continue to need additional funds to stay in business. At this time, we are not likely to be able to borrow enough money to continue operations on terms we find acceptable so we expect to have to sell more shares of common stock or more securities convertible in common stock. Convertible securities will likely have similar features to our existing preferred stock, including conversion at a discount to market. The sale of additional securities will further dilute your ownership of ATSI and put additional downward pricing pressure on the stock.

- THE POTENTIAL DILUTION OF YOUR OWNERSHIP OF ATSI WILL INCREASE AS OUR STOCK PRICE GOES DOWN, SINCE OUR PREFERRED STOCK IS CONVERTIBLE AT A FLOATING RATE THAT IS A DISCOUNT TO THE MARKET PRICE

Our Series A, D, E, F and G Preferred Stock is convertible into common stock based on a conversion price that is a discount to the market price for ATSI's common stock. The conversion price for the Series A, Series F and Series G Preferred Stock is reset each year on the anniversary of the issuance of the stock, and the conversion price for the Series D and Series E Preferred Stock floats with the market on a day-to-day basis. For each series, the number of shares of common stock that will be issued on conversion increases as the price of our common stock decreases. Therefore, as our stock price falls, the potential dilution to the common stock increases, and the amount of pricing pressure on the stock resulting from the entry of the new common stock into the market increases.

- SALES OF COMMON STOCK BY THE PREFERRED HOLDERS MAY CAUSE THE STOCK PRICE TO DECREASE, ALLOWING THE PREFERRED STOCK HOLDERS TO CONVERT THEIR PREFERRED STOCK INTO EVEN GREATER AMOUNTS OF COMMON STOCK, THE SALES OF WHICH WOULD FURTHER DEPRESS THE STOCK PRICE

The terms of the preferred stock may amplify a decline in the price of our common stock since sales of the common stock by the preferred holders may cause the stock price to fall, allowing them to convert into even more shares of common stock, the sales of which would further depress the stock price.

- THE HOLDERS OF CONVERTIBLE SUBORDINATED DEBENTURES ISSUED BY THE COMPANY DURING THE YEAR ENDED JULY 31, 2003 MAY CONVERT THOSE DEBENTURES INTO COMMON STOCK AT A CONVERSION RATE OF $0.135 PER SHARE

In January 2003 we issued 275 9% Convertible Subordinated Debentures with a face value of $1,000, due January 2005. The debentures convert into common stock at a conversion price of $0.135. The terms of the convertible debentures require us to adjust the conversion price if we sell common stock or securities convertible into common stock at a discount to market. Therefore, if we sell common stock or securities convertible into common stock in

the future on more favorable terms than those granted to the debenture holders, we will have to issue even more shares of common stock to the holders than initially agreed on. At July 31, 2003, the Company was in default of the terms of the debentures for non-payment.

- THE POTENTIAL DILUTION OF YOUR OWNERSHIP OF ATSI RESULTING FROM OUR SERIES D AND SERIES E PREFERRED STOCK WILL INCREASE IF WE SELL ADDITIONAL COMMON STOCK FOR LESS THAN THE CONVERSION PRICE APPLICABLE TO THE SERIES D AND

SERIES E PREFERRED STOCK

The terms of the Series D and Series E Preferred Stock require us to adjust the conversion price if we sell common stock or securities convertible into common stock at a greater discount to market than that provided for the Series D Preferred Stock and at less than the lower of the market price or the conversion price with respect to the Series E Preferred Stock. Therefore, if we sell common stock or securities convertible into common stock in the future on more favorable terms than the discounted terms, we will have to issue even more shares of common stock to the holders than initially agreed on.

- WE EXPECT TO ISSUE ADDITIONAL SHARES OF COMMON STOCK TO PAY DIVIDENDS ON THE PREFERRED STOCK, FURTHER DILUTING YOUR OWNERSHIP OF ATSI AND PUTTING ADDITIONAL DOWNWARD PRICING PRESSURE ON THE COMMON STOCK

The Series A and Series D Preferred Stock require quarterly dividends of 10% and 6% per annum, while our Series F and Series G Preferred Stock requires quarterly dividends of 15% per annum. We have the option of paying these dividends in shares of common stock instead of cash and we expect to use that option. The number of shares of common stock that are required to pay the dividends is calculated based on the same floating conversion price applicable to the conversion of the preferred stock, so the lower our common stock price, the more shares of common stock it takes to pay the dividends. The issuance of these additional shares of common stock will further dilute your ownership of ATSI and put additional downward pricing pressure on the common stock. The amount of dividends accrued as of July 31, 2003 is approximately $918,000 for our Series A, D, E, F and G Preferred Stock.

- YOU WILL ALMOST CERTAINLY NOT RECEIVE ANY CASH DIVIDENDS ON THE COMMON STOCK IN THE FORESEEABLE FUTURE

Sometimes investors buy common stock of companies with the goal of generating periodic income in the form of dividends. You may receive dividends from time to time on stock you own in other companies. We have no plan to pay dividends in the near future.

- OUR CERTIFICATE OF INCORPORATION AND BYLAWS AND DELAWARE LAW COULD MAKE IT LESS LIKELY THAT OUR STOCKHOLDERS RECEIVE A PREMIUM FOR THEIR SHARES IN AN UNSOLICITED TAKEOVER ATTEMPT

Certain provisions of our certificate of incorporation, our bylaws and the Delaware General Corporation Law could, together or separately, discourage potential acquisition proposals or delay or prevent a change in control. Currently, those provisions include a classified board of directors, a prohibition on written consents in lieu of meetings of the stockholders and the authorization to issue up to 10,000,000 shares of preferred stock and up to 200,000,000 shares of common stock. Our board of directors has the power to issue any or all of these additional shares without stockholder approval. The preferred shares can be issued with such rights, preferences and limitations as may be determined by the board. The rights of the holders of common stock will be subject to, and may be adversely affected by, the commitments or contracts to issue any additional shares of common stock or any shares of preferred stock. Authorized and unissued preferred stock and common stock could delay, discourage, hinder or preclude our unsolicited acquisition, could make it less likely that the stockholders receive a premium for their shares as a result of any such attempt and could adversely affect the market price of, and the voting and other rights of, the holders of outstanding shares of common stock.

ITEM 2. PROPERTIES

Our executive office is located at our leased facilities in San Antonio, Texas, consisting of 3,042 square feet. The lease expires September 2004. We pay annual rent of $41,040 under the lease. Management believes that our leased facilities are suitable and adequate for their intended use.

ITEM 3. LEGAL PROCEEDINGS

In March 2001, Comdisco sued ATSI-Texas for breach of contract for failing to pay lease amounts due under a lease agreement for telecommunications equipment. Comdisco claims that the total amount loaned pursuant to the lease was $926,185 and that the lease terms called for 36 months of lease payments. Comdisco is claiming that ATSI only paid thirty months of lease payments. ATSI disputes that the amount loaned was $926,185 since we only received $375,386 in financing. We have paid over $473,000 in lease payments and, thus, believe that we have satisfied our obligation under the lease terms. Currently Comdisco has filed a claim with the United States Bankruptcy Court of the Western District of Texas. We believe that this liability under ATSI Texas will be discharged upon the completion of the Chapter 7 case. The Chapter 7 bankruptcy trustee estimates that this case will be completed by December 2004, although there can be no assurance that such deadline will be met.

In July 2002, we were notified by the Dallas Appraisal District that our administrative appeal of the appraisal of our office in the Dallas InfoMart was denied. The property was appraised at over $6 million dollars. The property involved included our Nortel DMS 250/300 switch, associated telecommunications equipment and office furniture and computers. ATSI was unable to proceed in its appeal of the appraisal due to its failure to pay the taxes under protest. During fiscal 2002 we recorded approximately $260,000 of property tax expense related to our Dallas office. Currently the Dallas County taxing authority has filed claim with the United States Bankruptcy Court of the Western District of Texas for approximately $783,843. This amount also included a property tax estimate of approximately $230,572 for calendar year 2003. We believe this amount is incorrect; all of the property was removed and impaired from our Dallas site as a result of ATSI Texas filing for protection under Chapter 11 of the Bankruptcy code. We believe that this liability under ATSI Texas will be discharged upon the completion of the Chapter 7 case.

In December 2002, ATSI-Delaware and ATSI the Texas Corporation were both sued in Mexico for an alleged breach of a promissory note. The U.S. companies were guarantors on a promissory note to a Mexican telecommunications carrier. ATSI is vigorously defending the suits in Mexico, which are claiming approximately $200,000. ATSI believes it has a justifiable basis for its position in the litigation and believes that we will be able to resolve the dispute without suffering a material adverse effect on our financial position.

On October 31, 2002, we filed a lawsuit in the Southern District of New York against several financial parties for what ATSI believes is "stock fraud and manipulation". The case is based on convertible preferred stock financing transactions involving primarily two firms, Rose Glen Capital and the Shaar Fund. We believe that Rose Glenn and the Shaar Fund engaged in a scheme to defraud ATSI into selling multiple series of convertible preferred stock and to manipulate the price of our stock downward in order to take advantage of increased conversion rates resulting from the decline in stock price. As of the date of this filing, we do not know what the impact, positive or negative, of our filing a lawsuit against certain preferred stock holders will have on the trading of our stock as well as the price of our stock. If we were to lose the lawsuit, it is likely we would have to issue a substantial amount of shares to our Series D and Series E holders diluting your ownership of ATSI and putting substantial pressure on the common stock.

In June 20, 2003, we filed a lawsuit in the 150th Judicial District Court, Bexar County, Texas against NIFTI Communications Systems, LLC. for breach of contract, fraudulent misrepresentation, and negligent misrepresentation. On February 28, 2003 ATSI and NIFTI executed a Letter of Intent for NITFI to acquire ATSI's concession license in Mexico. NIFTI failed to provide proof of funding to consummate this transaction, lacked interest in the transaction and failed commit to a definite date for the completion of this transaction. As a result this transaction was never

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consummated and in May 2003 ATSI sold 51% of ATSICOM to Telemarketing. In July 21, 2003, NIFTI in turn filed a counter-claim against ATSI. Under the counter claim NIFTI states that ATSI failed to provide all the proper documentation related to the concession license liabilities, accounting and requirements by the Mexican Government. As of the date of this filing the lawsuit is ongoing. The Company does not believe the outcome will have a material adverse effect on our financial statements.

We are also a party to additional claims and legal proceedings arising in the ordinary course of business. We believe it is unlikely that the final outcome of any of the claims or proceedings to which we are a party would have a material adverse effect on our financial statements; however, due to the inherent uncertainty of litigation, the range of possible loss, if any, cannot be estimated with a reasonable degree of precision and there can be no assurance that the resolution of any particular claim or proceeding would not have an adverse effect on our results of operations in the period in which it occurred.

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

There were no submissions of matters to a vote of security holders during the fourth quarter of our fiscal year.

PART II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our Common Stock was quoted on the AMEX under the symbol "AI" until January 15, 2003 when the trading of our common stock was halted. The table below sets forth the high and low bid prices for the Common Stock from August 1, 2000 through January 14, 2003 as reported by AMEX. As of May 9, 2003 our common stock is traded in the pink sheets under the symbol "ATSC". The table below sets forth the high and low bid prices for the Common Stock from May 9, 2003 through July 31, 2003 as reported by OTC bulletin board. These price quotations reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not necessarily represent actual transactions.

FISCAL 2001	HIGH	LOW
FIRST -	$ 4	$1 3/8
SECOND -.	$ 1 13/16	$ 3/8
THIRD -	$ 1.34	$ 0.40
FOURTH -.	$ 0.70	$ 0.36

FISCAL 2002	HIGH	LOW

FIRST -	$ 0.42	$ 0.30
SECOND -.	$ 0.37	$ 0.24
THIRD -	$ 0.28	$ 0.21
FOURTH -.	$ 0.25	$ 0.07

FISCAL 2003	HIGH	LOW
FIRST -	$ 0.12	$0.03
SECOND - (THROUGH JANUARY 14, 2003)	$ 0.16	$0.07
THIRD - (TRADING HALTED)	-----	-----
FOURTH -.	$ 0.07	$0.01

The following table provides information relating to the grant of stock, options, and warrants pursuant to equity based compensation plans as of July 31, 2003.

PLAN CATEGORY	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS	NUMBER OF SECURITIES REMAINING AVAILABLE FOR FUTURE ISSUANCE UNDER EQUITY COMPENSATION PLANS (EXCLUDING SECURITIES REFLECTED IN COLUMN (a))
	(a)	(b)	(c)
EQUITY COMPENSATION PLANS APPROVED BY SECURITY HOLDERS	8,673,659	$ 0.78	5,990,001
EQUITY COMPENSATION PLANS NOT APPROVED BY SECURITY HOLDERS	-	-	-
TOTAL	8,673,659	$ 0.78	5,990,001

At July 31, 2003, the closing price of our Common Stock as reported by OTC bulletin board was $0.04 per share. As of July 31, 2003, we had approximately 15,000 stockholders, including both beneficial and registered owners. The terms of our Series A, Series D, Series E, Series F and Series G Preferred Stock restrict us from paying dividends on our Common Stock until such time as all outstanding dividends have been fulfilled related to the Preferred Stock. ATSI has not paid dividends on our common stock the past three years and does not expect to do so in the foreseeable future.

In June 2001, we issued 6,500 shares of our Series G preferred stock for approximately $650,000 of cash proceeds. Our Series G preferred stock converts to common stock at a discount to market originally defined as the Initial Conversion Price. On each Anniversary Date up to and including the second Anniversary Date, the Conversion Price on any unconverted Preferred Stock plus any accumulated, unpaid dividends will be reset to be equal to the average closing price of the stock for the five (5) preceding trading days. The Series G preferred stock accrues dividends at 15% per annum. And from the at all times from and after the Second Anniversary, the Conversion Price shall equal (A) .85 multiplied by (B) the Market Price of the Common Stock on the Second Anniversary. The amount of accrued and unpaid dividends as of the Conversation Date shall be paid in Common Stock valued at the Market Price on the Conversion Date. The Series G preferred stock was issued without any public solicitation to a limited number of investors. Each investor represented to us that the securities were being acquired for investment purposes only and not with an intention to resell or distribute such securities. Each of the investors had access to information about our business and financial condition and was deemed capable of protecting their own interests and were issued pursuant to the private placement exemption provided by Section 4(2) of the Securities Act of 1933. These are deemed to be "restricted securities" as defined in Rule 144 under the 1933 Act and the certificates representing shares of the Series G preferred stock bear a legend limiting the resale thereof.

ITEM 6. SELECTED FINANCIAL AND OPERATING DATA.

The following selected financial and operating data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and The Company's Consolidated Financial Statements and the Notes thereto included elsewhere herein.

	Years ended July 31,		
	1999	2000	2001
	(In thousands of $, except per		
CONSOLIDATED STATEMENT OF OPERATIONS DATA:			
Operating revenues			
Carrier services	$ 14,123	$ 22,192	$ 26,349
Network services	5,127	2,539	2,714
Total operating revenues	19,250	24,731	29,063
Cost of services (exclusive of depreciation and Amortization, as shown below)	13,751	20,463	24,802
Gross Margin	5,499	4,268	4,261
Selling, general and administrative expense	5,101	6,724	6,924
Impairment loss	-	-	-
Bad debt expense	2,295	756	142
Depreciation and amortization	1,882	2,020	2,045
Operating loss	(3,779)	(5,232)	(4,850)
Other income (expense), net	(1,240)	(1,388)	(300)

Net loss from continuing operations before income tax expense	(5,019)	(6,620)	(5,150)	
Income tax expense	-	-	-	
Net loss from continuing operations	(5,019)	(6,620)	(5,150)	
Net loss from discontinued operations	(1,716)	(3,432)	(5,403)	
Net loss from sale of discontinued operations	-	-	-	
Net loss	(6,735)	(10,052)	(10,553)	
Less: preferred stock dividends	(856)	(7,085)	(2,232)	
Net loss applicable to common shareholders	($7,591)	($17,137)	($12,785)	
PER SHARE INFORMATION:				
Net loss-basic and diluted	($0.16)	($0.30)	($0.18)	
Weighted average common shares outstanding-basic and diluted	47,467,000	56,852,000	71,180,000	8
CONSOLIDATED BALANCE SHEET DATA:				
Working Capital (deficit)	$ 946	$ 5,076	$ 1,936	
Current Assets from continuing operations	3,738	3,274	2,447	
Current Assets from discontinued operations	14,637	13,498	11,042	
Total Assets	25,267	26,894	23,112	
Current Liabilities from continuing operations	9,044	6,630	5,757	
Current Liabilities from discontinued operations	8,385	5,066	5,796	
Redeemable Preferred Shares	-	-	3,529	
Total Liabilities	19,130	13,544	13,329	
Total Stockholders' equity (deficit)	6,137	13,350	6,254	

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SPECIAL NOTE: This Annual Report on Form 10-K/A contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities and Exchange Act of 1934, as amended. "Forward looking statements" are those statements that describe management's beliefs and expectations about the future. We have identified forward-looking statements by using words such as "anticipate," "believe," "could," "estimate," "may," "expect," and "intend." Although we believe these expectations are reasonable, our operations involve a number of risks and uncertainties, including those described in the Additional Risk Factors section of this Annual Report Form 10-K/A and other documents filed with the Securities and Exchange Commission. Therefore, these types of statements may prove to be incorrect.

The following is a discussion of the consolidated financial condition and results of operations of ATSI for the three fiscal years ended July 31, 2001, 2002, and 2003. It should be read in conjunction with our Consolidated Financial Statements, the Notes thereto and the other financial information included elsewhere in this annual report on Form 10-K/A. For purposes of the following discussion, fiscal 2001 or 2001 refers to the year ended July 31, 2001, fiscal 2002 or 2002 refers to the year ended July 31, 2002 and fiscal 2003 or 2003 refers to the year ended July 31, 2003.

SOURCES OF REVENUE AND DIRECT COST

Sources of revenue:

Carrier Services: We provide termination services to U.S. and Latin American telecommunications companies who lack transmission facilities, require additional capacity or do not have the regulatory licenses to terminate traffic in Mexico. Typically these telecommunications companies offer their services to the public for local and international long distance services. Revenues from this service accounted for approximately 91% of our overall revenues in fiscal 2001, approximately 95% in fiscal 2002 and 94% in fiscal 2003. As discussed in the business section of this report, in December 2002, we were forced to idle our network and we were not able to restart our network during the fiscal year ending July 31, 2003. As a result we did not generate any revenue from this source during the second half of the fiscal year ending July 31, 2003. Subsequent to year-end we have signed three new carrier customers and we have generated revenues of approximately $36,000 during the first quarter of fiscal year 2004. However, there can be no assurance that revenue will continue to be generated at this level from these customers.

Network Services: We offer private communication links for multi-national and Latin American corporations or enterprise customers who use a high volume of telecommunications services to their U.S. offices or businesses and need greater dependability than is available through public networks. These services include data, voice and fax transmission as well as Internet services between the customers multiple international offices and branches. Currently we do not have any network services customers; however, we provide network management services to Latingroup Ventures L.L.C. (LGV), a non-related entity. Under the agreement with LGV we will provide customer service, technical support and manage the collections process of their private network customer. This management agreement was initiated on July 1, 2003 and we will generate approximately $12,700 per month in management fees through June 30, 2004.

Direct Cost:

Carrier Services: Under these services the Company incurs termination charges. These charges are related to the fees that we are charged by our carriers / vendors for the termination of phone calls into their infrastructure and network, primarily in Mexico. The cost is based on a per minute rate and volume. We additionally incur installation charges

from our various carriers; this cost is passed to our customers for the connection to the VoIP network from our carriers.

Network Services: Under the network services, the Company incurs satellite and fiber optic charges. The satellite and fiber optic charges are incurred as part of the connection links between the customer's different remote locations and sites to transmit data, voice and Internet services.

GENERAL

We have had operating losses for almost every quarter since we began operations in 1994. Due to such lossesas well as our recurring losses, as well as the negative cash flows generated from our operations and our substantial working capital deficit, the auditor's opinion on our financial statements as of July 31, 2003 calls attention to substantial doubts about our ability to continue as a going concern. This means that there is substantial doubt that we will be able to continue in business through the end of our next fiscal year, July 31, 2004.

We have experienced difficulty in paying our vendors and lenders on time in the past, and as a result on December 31, 2002 our carrier network capacity was idled and 27 US employees were terminated. This means that we were not able to generate revenues from carrier services during the second half of the fiscal year ending July 31, 2003. Revenues from carrier services accounted for approximately 91% of our overall revenues in fiscal 2001, 95% in fiscal 2002 and 94% in fiscal 2003.

During the fiscal year ending July 31, 2003 management continued to pursue different avenues for funding, but unfortunately, we were not able to raise the capital necessary to re-start our network, and as a result two of our subsidiaries, ATSI (Texas), Inc. and TeleSpan, Inc., filed for protection under Chapter 11 of the U.S. Bankruptcy Code on February 4, 2003 and February 18, 2003 respectively. Additionally, the court ordered joint administration of both cases on April 9, 2003 and subsequently on May 14, 2003 the court converted the cases to Chapter 7. The two bankrupt subsidiaries were our two primary operating companies and they have ceased operations. These bankruptcies did not include the reporting entity (the SEC registrant). As a result of the Chapter 7 bankruptcy of our two main operating subsidiaries, combined with the termination of the majority of our US Telco employees and the idling of the carrier network capacity, our ability to generate any revenue from our historical revenue generation sources was severely limited.

On July 02, 2003, the U.S. Bankruptcy Court overseeing the Chapter 7 cases for ATSI Texas and TeleSpan approved the sale of two of its foreign subsidiaries, ATSI-Mexico and SINFRA to Latingroup Ventures, L.L.C. (LGV), a non-related party. Under the purchase agreement, LGV acquired all the communication centers and assumed all related liabilities related to ATSI Mexico and SINFRA. Additionally, under the agreement, LGV" acquired the Comercializadora License owned by ATSI-Mexico and the Teleport and Satellite Network License owned by SINFRA. Due to the bankruptcies and the resulting sales of ATSI Mexico and SINFRA, we no longer had Mexico Telco operations, consisting primarily of retail call center operations, and determined to discontinue this operating segment.

On May 22, 2003 we entered into a Share Purchase Agreement with Telemarketing de Mexico, S.A. de C.V. (Telemarketing) whereby we sold Telemarketing 51% of our Mexican subsidiary, ATSI Comunicaciones, S.A. de C.V. (ATSICOM). ATSICOM holds a 30-year long distance concession in Mexico. The concession allows for the sale of voice and data services, long distance transport, and the operation of a telecommunications network. The principal owners of Telemarketing are also the principal owners of DialMex, LLC (DialMex) a U.S. based international telecommunications carrier. The agreement with Telemarketing provides that ATSI and Telemarketing will jointly enhance DialMex's VoIP network. On May 22, 2003, we also signed a carrier service agreement with DialMex, under the agreement with DialMex we will be allowed to use DialMex's VoIP network to transport and terminate voice and fax communications over the Internet. Our fees under the DialMex agreement will be based on a per minute rate on the volume of minutes sent through their VoIP network. Telemarketing and ATSI will enhance the

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VoIP network by linking DialMex's VoIP network with other carriers, which will enable us to reduce our transportation and termination costs, while simultaneously increasing and expanding destination points available to our customers. We believe that this lower network cost structure will allow the companies to be more competitive and attract more customers. Additionally, we will combine our respective interconnection agreements with the major carriers in Mexico to lower our termination cost and allow for a more attractive cost structure. The sale of our Mexican subsidiary to Telemarketing provides us with working capital while the agreement with DialMex provides us with access to a reliable and flexible state-of-the-art VoIP network without incurring the expense of operating such a network. Due to the financial condition of the Company, there can be no assurance that the enhancements can be made or that the costs will be decreased.

ATSI was founded in 1993. We are an international carrier, serving the rapidly expanding communications markets in and between Latin America and the United States. Our mission is to connect the Americas with exceptional communication services. Our strategy is to become a leading provider of communication services to carriers and businesses in this U.S./Latin American corridor through a high quality, 'next generation' VoIP network established through our partnership with DialMex.

ATSI's 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.

Our limited cash flow, historical losses from operations, the bankruptcies of our two main operating subsidiaries and sale of our retail services business have caused substantial barriers to growth and the continuation of our business strategy. Operationally, ATSI's strength lies in our interconnection agreements with carriers such as Telefonos de Mexico S.A de C.V. (Telmex) and Bestel S.A de C.V. and our 49% interest in ATSICOM, which owns a long distance concession license. Our interconnection agreements with these long-distance concessionaires provide us with nationwide network coverage at a competitive cost structure. Currently, Telmex owns and operates the only nationwide network in Mexico with more than 14.1 million phone lines in over 105,000 communities throughout Mexico. Bestel operates a fiber optic network that extends over 6,356 kilometers with points of presence in 19 Mexican metropolitan areas. Under these agreements the cost will be based on a per minute rate and the volume of minutes transported through their respective networks. Additionally, we own 49% of a Mexican company, ATSI Comunicaciones, S.A. de C.V., that holds a 30 year concession, allowing for the sale of voice and data services, long distance transport, and the operation of a telecommunications network. Through interconnection agreements established by ATSI Comunicaciones, S.A de C.V. and our partnership with DialMex, LLC, we are leveraging off the networks of third parties in Mexico, such as Alestra and Marcatel to build a reliable international network to support carrier-generated traffic between the U.S. and Mexico.

OUR HISTORY OF OPERATING LOSSES AND DEFICIENCIES IN CASH FLOW

We have incurred operating losses and deficiencies in operating cash flows in each year since our inception. Our operating losses from continuing operations were approximately $4,850,000, $8,259,000 and $5,780,000 for the years ending July 31, 2001, 2002 and 2003, respectively. We had an operating loss of approximately $1,579,000 for the quarter ended July 31, 2003. Additionally we had a working capital deficit of approximately $17,796,000, at July 31, 2003.

RESULTS OF OPERATIONS

The following table sets forth certain items included in our results of operations in thousands of dollar amounts and as a percentage of total revenues for the years ended July 31, 2001, 2002 and 2003.

	Year ended July 31,					
	2001		2002		2003	
	$	%	$	%	$	
Operating revenues						
Services						
Carrier services	$ 26,349	91%	$ 41,190	95%	$ 6,532	
Network services	2,714	9%	1,956	5%	417	
Total operating revenues	29,063	100%	43,146	100%	6,949	
Cost of services (exclusive of depreciation and amortization shown below)	24,802	85%	39,077	91%	6,244	
Gross Margin	4,261	15%	4,069	9%	705	
Selling, general and administrative expense	6,924	24%	6,866	16%	4,803	
Impairment loss	-	0%	3,119	7%	418	
Bad debt expense	142	0%	388	1%	35	
Depreciation and amortization	2,045	7%	1,955	5%	1,229	
Operating loss	(4,850)	-17%	(8,259)	-19%	(5,780)	
Other income (expense), net	(300)	-1%	1,475	3%	(2,922)	
Net loss from continuing operations before income tax expense	(5,150)	-18%	(6,784)	-16%	(8,702)	-
Income tax expense	-	0%	-	0%	-	
Net loss from continuing operations	(5,150)	-18%	(6,784)	-16%	(8,702)	-
Net loss from discontinued operations	(5,403)	-19%	(8,815)	-20%	(2,919)	
Net loss from sale of discontinued operations	-	0%	1,082	3%	(962)	
Net loss	(10,553)	-36%	(14,517)	-34%	(12,583)	-
Less: preferred stock dividends	(2,232)	-8%	(472)	-1%	(653)	
Net loss applicable to common shareholders	($12,785)	-44%	($14,989)	-35%	($13,236)	-

YEAR ENDED JULY 31, 2003 COMPARED TO YEAR ENDED JULY 31, 2002

Operating Revenues. Consolidated operating revenues decreased 84% between periods from $43 million for the year ended July 31, 2002 to $7 million for the year ended July 31, 2003.

Carrier services revenues decreased approximately $34.7 million, or 84% from the year ended July 31, 2002 to the year ended July 31, 2003. As the telecom sector has continued to suffer financially and operationally, more and more of our carriers require substantial deposits and/or prepayments. As a result of the substantial deposits and prepayment requirements and our lack of liquidity, in December 31, 2002, the Company idled its network and during the second half of the year ended July 31, 2003 we were not able to generate revenue from carrier services. During the same six-month period in fiscal year 2002, we generated approximately $21 million or approximately 50% of the total yearly carrier services revenue. Subsequent to year-end we have signed three new carrier customers and we have generated revenues of approximately $36,000 during the first quarter of fiscal year 2004. However, there can be no assurance that such revenue will continue to be generated at these levels from these customers.

Network services revenues decreased approximately 79% or $1.5 million from the year ended July 31, 2002 to the year ended July 31, 2003. Currently we do not have any network services customers; however, we currently provide network management services to Latingroup Ventures L.L.C. (LGV), a non-related party. Under the agreement with LGV we will provide customer service, technical support and manage the collections process of their private network customer. This management agreement was initiated on July 1, 2003 and we will generate approximately $12,700 per month in management fees through June 30, 2004.

Cost of Services. The consolidated cost of services decreased by $32.8 million, or 84% from the year ended July 31, 2002 to the year ended July 31, 2003. The decrease in cost of services is a direct result of the decrease in carrier services revenues and private network revenue. As mentioned above, we idled our network in December 2002 and as a result did not generate any revenue or cost of services related to carrier services during the second half of fiscal year 2003. During the same six-month period in fiscal year 2002, we incurred approximately $19.9 million in carrier services cost of services.

Selling, General and Administrative (SG&A) Expenses. SG&A expenses decreased approximately $2.1 million, or 30% between periods. The decrease can mainly be attributed to the termination of approximately 27 employees associated with carrier services business unit and network services in January 2003. The termination of these employees resulted in a decrease in salaries and wages of approximately $195,000 per month or $1.2 million over the second half of fiscal year 2003. Additionally, as a result of the termination of these employees, during the second half of fiscal year 2003, the company recognized a significant decrease in health and business insurance expense of approximately $96,000 per month or $576,000 during the period.

Impairment losses. During the year ended July 31, 2003, we recorded an impairment loss totaling approximately $418,000. The impairment losses during the fiscal year 2003 can be attributed to the impairment of leasehold improvements and other equipment as a result of idling our network during the second half of fiscal year 2003. In addition during the year ended July 31, 2002 we determined that the estimated future cash flows expected from the concession license and certain equipment and other assets was less than its carrying value. Therefore, we recorded an impairment of approximately $2,039,000 to reduce the recorded value of the concession license and approximately $1,080,000 to reduce the recorded value of equipment and other assets.

Depreciation and Amortization. Depreciation and amortization decreased by approximately 37% or $726,000 between periods. The decline is related to the fact that much of our equipment had been fully depreciated or impaired.

Operating Loss. The Company's operating loss decreased approximately $2.5 million or 30% from the year ended July 31, 2002 to the year ended July 31, 2003. The decrease is attributed to the decrease between periods in SG&A of $2.1 million and a decrease between periods of impairment expense of approximately $2.7 million. These decreases were offset somewhat by the decrease in gross margin dollars of approximately $3.3 million between periods.

Other Income (expense). Other income decreased approximately $4.4 million between periods from $1.5 million in other income to $2.9 million on other expense during the fiscal year ended July 31, 2003. This change can be attributed to various factors, during the fiscal year 2003, we incurred approximately $1,009,000 in loss from the sale of various telecommunications assets from continuing operations; this loss is attributed to the sale of ATSI Texas and TeleSpan telecommunication equipment by the Chapter 7 Bankruptcy trustee. Additionally, during the fiscal year 2003 we recognized a loss of approximately $511,000 related to the sale of 51% of our ownership in one of our subsidiaries, ATSICOM. We also recognized during fiscal year 2003 additional interest expense of approximately $401,000 associated with the default of ATSI Texas in its capital lease with IBM. We also recognized during fiscal year 2003 approximately $924,000 in interest expense associated with other capital leases and we recognized approximately $52,000 in interest expense associated with various notes payables.

Loss from discontinued operations. Loss from discontinued operations decreased by $5.9 million between periods, from $8.8 million to $2.9 million during the fiscal year ended July 31, 2003. During fiscal year 2003, we recognized loss from discontinued operations of approximately $2.9 associated with Mexico Telco operations. During fiscal year 2002 we recognized a gain from discontinued operations of approximately $399,000 related to the discontinued operations of the E-commerce operations. Additionally, during fiscal year 2002, we also recognized approximately $9,215,000 of loss from discontinued operations related to the Mexico Telco operations. The Mexico Telco loss from discontinued operations during fiscal year 2002 can mainly be attributed to the recognition of the impairment loss of Computel's goodwill of approximately $3.3 million. Additionally, in fiscal year 2002 we incurred $1.5 million in interest expense associated with the IBM capital lease

Net gain or loss from sale of discontinued operations. During fiscal year 2003, we recognized a loss from sale of discontinued operations of approximately $962,000 attributable to the loss on the sale of ATSI Mexico and Sinfra. Additionally, during fiscal year 2002, we recognized a gain from the sale of discontinued operations of approximately $1,082,000 associated with gain on sale of GlobalScape.

Preferred Stock Dividends. During the year ended July 31, 2003, we recorded approximately $653,000 of non-cash dividends related to our cumulative convertible preferred stock. This compares unfavorably to the approximately $472,000 of non-cash dividends recognized during the year ended July 31, 2002. The increase is mainly attributed to the accrual of approximately $284,000 of preferred stock dividends in relation to the redemption letter received from the Series D Preferred Shareholder during fiscal year ended July 31, 2003.

Net loss to Common Stockholders. The net loss for the year ended July 31, 2003 decreased to $13,236,000 million from $14,990,000 million for the year ended July 31, 2002. The decrease in net loss was due primarily to the idling of our network, not incurring any fixed and variable costs associated with the leasing of satellite sites, connectivity fees and operating a network site during the second half of fiscal year 2003. During the same six-month period in fiscal year 2002, we incurred approximately $20 million or 53 % of the total yearly carrier services variable and fixed costs. Additionally, during the same period we terminated approximately 27 employees associated with the carrier services and network services business unit. The termination of these employees resulted in a decrease in salaries and wages of approximately $195,000 per month or $1.2 million over the second half of fiscal year 2003.

YEAR ENDED JULY 31, 2002 COMPARED TO YEAR ENDED JULY 31, 2001

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Operating Revenues. Consolidated operating revenues increased 48% between periods from $29 million for the year ended July 31, 2001 to $43.2 million for the year ended July 31, 2002. As demand for our services increased, we began adding capacity to both the switch and the network backbone in October 2001. The net effect of our efforts during the year was three of the four highest quarters of revenues in our history.

Carrier services revenues increased approximately $14.9 million, or 56% from 2001 to 2002. As a result of our efforts to add capacity, the units transported via our network increased from approximately 277 million minutes of traffic during the year ended July 2001 to approximately 458 million minutes of traffic during the period ended July 2002.

Network services decreased by approximately $758,000 or 28% between years. The decline is attributable to a decreased volume of units transported via our network and the loss of customers in our private network services business between years. In October 2002, we completed the sale of our Costa Rica private network services, which further reduced our networks services revenues in fiscal 2003.

Cost of Services. Cost of services increased 58% between periods from $24 million for the year ended July 31, 2001 to $39 million for the year ended July 31, 2002. The increase in cost of services is directly attributed to the increase in demand of services from our customers. As discuss in the carrier revenue section, our units of traffic carried during fiscal year 2002 grew by 181 million minutes from the fiscal year ended July 31, 2001.

Selling, General and Administrative (SG&A) Expenses. SG&A expenses decreased approximately $58,000, or 1% between periods. The improvement, resulted from management's efforts to cut excess spending by each department during fiscal 2002. As a percentage of revenues, SG&A declined from 24% to 16% period to period.

Impairment loss. During fiscal 2002 we recorded approximately $3.1 million of impairment loss. During the year ended July 31, 2002 we determined that the estimated future cash flows expected from the concession license and certain equipment and other assets was less than its carrying value. Therefore, we recorded an impairment of approximately $2,039,000 to reduce the recorded value of the concession license and approximately $1,080,000 to reduce the recorded value of equipment and other assets related to ATSI Comunicaciones concession license. No impairment expense was recorded in fiscal 2001.

Bad Debt Expense. Bad Debt Expense increased by approximately $246,000 between periods due primarily to expense related to write-off of certain receivable from Global Crossing and WorldCom, these two companies filed for bankruptcy and the receivables were consider not collectable during fiscal year 2002.

Depreciation and Amortization. Depreciation and amortization decreased by approximately 4% or $90,000 between periods due to some of the equipment being fully depreciated during early periods of fiscal 2002.

Operating Loss. The Company's operating loss increased by approximately $3.4 million due to the impairment loss recorded in fiscal 2002.

Other Income (expense). Other expense decreased approximately $1.8 million between years. The primary reason for the decrease in other income can be attributed to the restructuring of IBM capital lease in the forth quarter of fiscal 2002. This restructuring resulted in a gain of approximately $1.9 million.

Loss from discontinued operations. The net loss from our e-commerce operations and retail services (Mexico Telco) net of taxes, during fiscal 2002 was $8,816,000 as compared to a net loss of $5,403,000 for fiscal 2001. During fiscal year 2002 we recognized a gain from discontinued operations of approximately $399,000 related to the discontinued operations of the E-commerce operations. Additionally, during fiscal year 2002, we also recognized approximately $9,215,000 of loss from discontinued operations related to the Mexico Telco business unit. The Mexico

Telco loss from discontinued operations during fiscal year 2002 can mainly be attributed to the recognition of the impairment loss of Computel's goodwill of approximately $3.3 million. Additionally, in fiscal year 2002 we incurred $1.5 million in interest expense associated with the IBM capital lease.

Net gain or loss from sale of discontinued operations. During fiscal year 2002, we recognized a gain from the sale of discontinued operations of approximately $1,082,000 associated with gain on sale of GlobalScape.

Preferred Stock Dividends. During the year ended July 31, 2002, we recorded approximately $472,000 of non-cash dividends related to our cumulative convertible preferred stock. This compares favorably to the approximate $2.2 million of non-cash dividends and beneficial conversion feature expense recognized during the year ended July 2001.

Net loss to Common Stockholders. The net loss for the year increased by approximately $2.2 million to $15.0 million from the $12.8 million net loss for the year ended July 2001. The increase was due primarily to the impairment loss of $3.1 million recorded in fiscal 2002 offset somewhat by a significant increase in revenues, which improved our gross margin dollars. An additional offset between years was the reduction in selling, general and administrative expenses and preferred dividends.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by / used in operating activities:

During the year ended July 31, 2003, we generated cash from operations of approximately $129,000. We generated this positive cash flow from operations as a result of an increase in accrued liabilities and accounts payables of approximately $2.9 million and $3.2 million, respectively. The increase in accrued liabilities and accounts payable is primarily due to the company not being able to generate sufficient cash inflows from operations to cover operating expense, for example direct cost and SG&A expenses. As a result of the company not being able to meet its obligations with various vendors, on December 31, 2002, the Company idled its network and during the second half of the year ended July 31, 2003 we were not able to generate revenue from carrier services. During the same six-month period in fiscal year 2002, we generated approximately $21 million or approximately 50% of the total yearly carrier services revenue. Subsequent to year-end we have signed three new carrier customers and we have generated revenues of approximately $36,000 during the first quarter of fiscal year 2004. However, there can be no assurance that such revenue will continue to be at this level from these customers. We believe that these levels of revenue will not be sufficient to cover operating salaries and general and administrative expense. Currently, as stated below, we depend on the monthly payments of approximately $20,000 from the sale of 51% of ATSI Comunicaciones S.A de C.V. to Telemarketing S.A de C.V. to pay for our monthly SG&A expenses. Currently we generate approximately $45,000 in SG&A expenses. We expect this financial instability and lack of liquidity to continue during the first and second quarter of fiscal year 2004. As a result over the next twelve months we estimate requiring additional funding of approximately $300,000 to compensate for the deficiencies in cash inflows.

Cash provided by / used in investing activities:

During the year ended July 31, 2003, the Company acquired approximately $281,000 in equipment. This equipment was acquired by our operating entities, ATSI Texas and TeleSpan, Inc during the first quarter for fiscal year 2003. Subsequently this equipment was retained by the bankruptcy trustee when these entities filed for Chapter 11 protection during the third quarter of fiscal year 2003. As previously discussed ATSI (Texas), Inc. and TeleSpan, Inc., filed for protection under Chapter 11 of the U.S. Bankruptcy Code on February 4, 2003 and February 18, 2003 respectively. Additionally, the court ordered joint administration of both cases on April 9, 2003 and subsequently on May 14, 2003 the court converted the cases to Chapter 7 bankruptcies. The two bankrupt subsidiaries were our two primary operating companies and they have ceased operations. Currently the Chapter 7 trustee controls and manages these two entities. The Chapter 7 trustee administers the liquidation of all of the assets of these entities and the

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negotiations with all the creditors of record under the bankruptcy. In July 2003, the Chapter 7 trustee enforced its rights under the bankruptcy and sold ATSIMEX and SINFRA, the two foreign subsidiaries owned by ATSI Texas and TeleSpan. The bankruptcy judge approved the sale of these entities to Latingroup Ventures, LLC. The sale price for these entities was $17,500; the Chapter 7 trustee received the funds and is restricting its use to liquidate and close these entities. These bankruptcies did not include the reporting entity (the SEC registrant), and it is excluded from any matters related to these entities. These entities are the sole responsibility of the Chapter 7 trustee.

Additionally, during the fourth quarter of fiscal year 2003, as discussed below; ATSI Delaware received approximately $440,000 from the sale of 51% of ATSICOM. Of the funds received from the sale of ATSICOM, $200,000 were restricted to pay off ATSICOM's liabilities; the remaining funds were utilized to cover the monthly selling, general and administrative expense associated with restarting carrier services.

Cash flows used in / provided by financing activities:

During the fiscal year 2003, we had cash outflows of approximately $87,000 towards our capital lease obligations. Additionally, we received approximately $25,000 for the issuance of debt during fiscal year 2003. (See footnote No: 11 to the consolidated financial statements) Furthermore, during fiscal year 2003, we recognized payments related to the issuance of preferred stock and issuance of common stock of approximately $12,000 and $95,000 respectively.

Overall, the Company's net operating, investing and financing activities during the year ended July 31, 2003 provided an increase of approximately $137,000 in cash balances. We intend to cover our monthly operating expenses with our remaining available cash. However, as discussed previously we are also dependent on the monthly cash payments from the sale of ATSICOM to cover monthly operating expenses.

The Company's working capital deficit at July 31, 2003 was approximately $17.8 million. This represents an increase of approximately $7.7 million from our working capital deficit at July 31, 2002. The increase is primarily attributed to our deficiency of cash and the accumulation of debt from our various carriers and creditors.

In May 2002, the Company announced that it had renegotiated its capital lease agreement with IBM. The agreement calls for forty-two payments commencing July 31, 2002, consisting of six payments of $50,000 and thirty-six payments of $75,000. As of the date of this filing, we have made one payment totaling $50,000. As we continue to be in default of the agreement as of July 31, 2003, the entire principal balance of $2.3 million is reflected in current liabilities. As of the date of this filing, IBM Corporation filed a claim against ATSI Texas and TeleSpan, Inc, the two subsidiaries under the Chapter 7 case for the total outstanding balance. The Chapter 7 Bankruptcy trustee is managing the relationship with this creditor and we believe that this liability will be discharged upon termination of the Chapter 7 cases for these entities.

In May 2002, the Company entered into a Forbearance Agreement with NTFC Capital Corporation related to its capital lease facility. In exchange for a payment of approximately $500,000 NTFC agreed to release GlobalSCAPE, Inc. as a co-borrower under the facility. Additionally, on May 12, 2003 the United States Bankruptcy Court Judge handling the Chapter 7 cases of ATSI Texas and TeleSpan, Inc. ordered the enforcement of the security interest. As a result, NTFC took possession of the equipment under the capital lease and was ordered to release ATSI Texas and ATSI Delaware from any liability. As a result of this judgment we reduced our liabilities under the Chapter 7 case by approximately $1.1 million including accrued interest. As a result, we recognized an impairment loss on the equipment related to this transaction of approximately $232,000 and reduced assets of approximately $1,316,000.

The Company's current liabilities include approximately $1.3 million of equipment purchased from Northern Telecom, a subsidiary of Nortel Networks in fiscal 2001. Approximately $386,000 of the amount due Northern Telecom is in the form of a note payable, the remaining $850,000 is in accounts payable. In June 2002, the Company

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reached an agreement with Nortel related to this payable. In return for a reduction of $314,000 in the price of the equipment and additional technical support related to the equipment, ATSI agreed to make payments over a ten-month period beginning July 15, 2002 totaling approximately $936,000. As of the date of this filing, no payments have been made and we have removed the equipment with an original value of approximately $850,000 from our network with the intent of returning the equipment to Northern Telecom. As of the date of this filing, Northern Telecom filed a claim against ATSI Texas and TeleSpan, Inc, the two subsidiaries under the Chapter 7 case, for the total outstanding balance. The Chapter 7 Bankruptcy trustee is managing the relationship with this creditor and we believe that this liability will be discharged upon termination of the Chapter 7 cases for these entities.

The Company's current obligations also include approximately $1,367,000 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. Of this amount, $357,000 is included in notes payable and the additional $1,030,000 is included in accrued liabilities.

Additionally, we also have a note with the taxing authorities in Mexico for $452,459 related to a note assumed through the acquisition of Computel, (see note 23) and a note payable with two related parties for $250,000 and $25,000, respectively. In July 2003, the Company entered into a note payable with a non-related company, in the amount of $62,500. (See footnote No: 11 of the consolidated financial statements for details on these notes payable)

We believe that, based on our limited availability to capital resources and our current cash balances, that these resources may not be available to support our ongoing operations for the next twelve months or until we are able to generate income from operations. 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. Currently, management will utilize the funds from the sale of ATSICOM to fund operations. As previous discussed, in May 2003, the company entered into a Share Purchase Agreement with Telemarketing de Mexico, S.A. de C.V. (Telemarketing) whereby we agreed to sell Telemarketing 51% of our Mexican subsidiary, ATSI Comunicaciones, S.A. de C.V. (ATISCOM). The agreement provides that there will be an initial payment of $194,000 plus payment of approximately $200,000 of ATSICOM'S liabilities and the remaining purchase price of $747,000 will be paid as follows:

- Beginning in May 2003 Telemarketing will pay ATSI $20,750 per month for 12 months.
- Additionally, beginning in May 2004, Telemarketing will pay ATSI $20,750 per month for the next 24 months, contingent on ATSI generating 20,750,000 minutes of monthly traffic through ATSICOM's network. In the event the company does not reach the above-mentioned volume of monthly minutes, the monthly payment will be adjusted based on the same percentage of the shortfall in minutes, until Telemarketing pays the total purchase price. On the other hand, if ATSI exceeds the volume of monthly traffic, Telemarketing can make additional payments, without penalty.

There can be no assurance that we will be able to continue to operate with these funds over the next twelve months or that we will be able to generate sufficient cash from operations to cover our monthly operating expenses. Additionally, there is no assurance that we will be able to raise the additional capital from equity of debt sources required to continue in operations.

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

In April 2003, we entered into a six-month operating lease with BDRC, INC., for the lease of our executive office. In September 2003 we renewed this lease for one more year and will expire in October 2004. Under the lease we will pay annual rent of approximately $42,000 for 3,040 square feet of office space.

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MARKET RISK

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

Commodity Price Risk

The carrier services market is an extremely price sensitive environment. The carrier services business over the past twelve months has seen significant reductions in the price per minute charged for transporting minutes of traffic. We might not be able to withstand these pricing pressures as certain of our competitors are much larger and better positioned to withstand these price reductions. Our ability to absorb these price reductions may be dependent on our ability to further reduce our costs of transporting these minutes.

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 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.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF ATSI COMMUNICATIONS, INC.

We have audited the consolidated balance sheets of ATSI COMMUNICATIONS, INC. AND SUBSIDIARIES as of July 31, 2003 and 2002, and the related consolidated statements of operations, comprehensive loss, stockholders' deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The financial statements of ATSI COMMUNICATIONS, INC. AND SUBSIDIARIES for the year ended July 31, 2001 were audited by other auditors who have ceased operations and whose report dated October 18, 2001 on those statements included an explanatory paragraph describing conditions that raised substantial doubt about the Company's ability to continue as a going concern. As described in Note 23 the Company has restated its 2001 consolidated financial statements to report discontinued operations, in conformity with accounting principles generally accepted in the United States of America. The other auditors reported on the 2001 financial statements before the restatement.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed above, the consolidated financial statements of ATSI COMMUNICATIONS, INC. AND SUBSIDIARIES as of July 31, 2001 were audited by other auditors who have ceased operations. As described in Note 23, these consolidated financial statements have been restated. We audited the adjustments described in Note 23 that were applied to restate the 2001 consolidated financial statements. In our opinion, such adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2001 consolidated financial statements of the Company other than with respect to such adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2001 consolidated financial statements taken as a whole.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ATSI COMMUNICATIONS, INC. AND SUBSIDIARIES as of July 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for the years ended July 31, 2003 and 2002 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 4 to the consolidated financial statements, the Company has a working capital deficit, has suffered recurring losses and has a stockholders' deficit. These conditions raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 4. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/S/ TANNER + CO.

SALT LAKE CITY, UTAH
OCTOBER 3, 2003

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Management, Directors and Shareholders of ATSI Communications, Inc.:

We have audited the accompanying consolidated balance sheet of ATSI Communications, Inc. (a Delaware corporation) and subsidiaries (the Company) as of July 31, 2000 and 2001, and the related consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows for the years ended July 31, 1999, 2000 and 2001. These financial statements are the responsibility of Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ATSI Communications, Inc. and subsidiaries as of July 31, 2000 and 2001, and the results of their operations and their cash flows for the years ended July 31, 1999, 2000 and 2001, in conformity with accounting principles generally accepted in the United States.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the consolidated financial statements, the Company has a working capital deficit, has suffered recurring losses from operations since inception, has negative cash flows from operations and has limited capital resources available to support further development of its operations. These matters raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts including goodwill and other intangibles or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

/s/ ARTHUR ANDERSEN LLP

San Antonio, Texas
October 18, 2001

NOTE:

THIS REPORT IS A COPY OF THE REPORT PREVIOUSLY ISSUED BY ARTHUR ANDERSEN LLP AS OF AND FOR THE PERIODS INDICATED ABOVE. ARTHUR ANDERSEN LLP HAS NOT REISSUED THIS REPORT.

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

ASSETS

CURRENT ASSETS:
Cash and cash equivalents
Cash-restricted
Accounts receivable, net of allowance of $189 and $102, respectively
Note Receivable-current portion
Inventory
Prepaid & Other current assets
Assets from discontinued operations

Total current assets

PROPERTY AND EQUIPMENT
Less - Accumulated depreciation and amortization

Net property and equipment

OTHER ASSETS, net
Note Receivable
Investment in unconsolidated subsidiary
Concession License, net
Other

Total assets

LIABILITIES AND STOCKHOLDERS' DEFICIT

CURRENT LIABILITIES:
Accounts payable
Accrued liabilities
Notes payable
Convertible debentures
Current portion of obligations under capital leases
Deferred revenue
Liabilities from discontinued operations

Total current liabilities

LONG-TERM LIABILITIES:
Obligations under capital leases, less current portion
Long Term Advances payable
Other

Total long-term liabilities

COMMITMENTS AND CONTINGENCIES
REDEEMABLE PREFERRED STOCK:
Series D Cumulative Preferred Stock, 3000 shares authorized, 742 shares issued and outstanding.
Series E Cumulative Preferred Stock, 10,000 shares authorized, 1,455 and 1,170 shares issued and outstanding, respectively

STOCKHOLDERS' DEFICIT:
Preferred Stock, $0.001 par value, 10,000,000 shares authorized,
Series A Cumulative Convertible Preferred Stock, 50,000 shares authorized, 4,370 shares issued and outstanding.
Series F Cumulative Convertible Preferred Stock, 10,000 shares authorized, 7,260 shares issued and outstanding.
Series G Cumulative Convertible Preferred Stock, 42,000 shares authorized, 6,500 shares issued and outstanding.
Common stock, $0.001, 200,000,000 shares authorized, 94,790,855 and 103,638,690 issued and outstanding, respectively
Additional paid in capital
Accumulated deficit
Warrants Outstanding
Other Comprehensive (Loss) Income

Total stockholders' deficit

Total liabilities and stockholders' deficit