ATSI COMMUNICATIONS INC/DE
Form 10-K
October 15, 2009

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

FORM 10-K

(mark one)
x ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended July 31, 2009

or

¨ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _______to _________

Commission File Number: 001-15687

ATSI COMMUNICATIONS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Nevada	74-2849995
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

3201 Cherry Ridge, Building C, Suite 300
San Antonio, Texas 78230
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Cod: (210) 614-7240

Securities registered under Section 12(b) of the Securities Exchange Act: NONE

Securities registered under Section 12(g) of the Securities Exchange Act:

Common Stock, Par Value $0.001 Per Share
(Title of Class)

Indicate by check mark if the registrant is a well-know seasoned issuer, as defined in Rule 405 of the Securities Act.
¨ Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act.
¨ Yes x No

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
¨ 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, 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-KSB. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) ¨ Yes x No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the issuer was $3,270,946 based on the closing price of $0.09 per share on January 31, 2009, as reported on the over-the-counter bulletin board.

There were 45,504,120 shares of issuer's Common Stock outstanding as of October 14, 2009.

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PART I

ITEM I. DESCRIPTION OF BUSINESS.

Overview

We are an international telecommunications carrier that utilizes the Internet to provide cost-efficient and economical international telecommunication services. Our current operations consist primarily of providing digital voice communications over the Internet using Voice-over-Internet-Protocol ("VoIP"). We provide high quality voice and enhanced telecommunication services to carriers, telephony resellers and other VoIP carriers through various agreements with service providers in the United States, Mexico, Asia, the Middle East and Latin America utilizing VoIP technology. Typically, these telecommunications companies offer their services to the public for domestic and international long distance services. In addition, we provide private communications links and VoIP gateway services.

History

ATSI Communications, Inc., a Nevada corporation, was formed in 2004 as the successor to the business originally incorporated 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. Our stockholders voted to change our name from American TeleSource International, Inc. to ATSI Communications, Inc. in 2003 and to reincorporate in the State of Nevada by merger into our wholly owned subsidiary in 2004. We operate through our wholly owned subsidiary, Digerati Networks, Inc. ("Digerati"). Digerati is a premier global VoIP carrier providing international communication services that consist primarily of transporting voice traffic across the world via the Internet. Additionally, we own 49% of ATSI Comunicaciones S.A de C.V. (ATSICOM), 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 in Mexico.

Recent Developments

During the year ended July 31, 2009 ("fiscal 2009"):

- Entered into a promissory note with San Antonio National Bank and Texas Ventures for $425,000 and $850,000, respectively. The financing arrangement provides us with access to capital to fund our growth initiatives and allows us to service top tier customers that required extended payment terms.

- Deployed a VoIP technology platform to introduce enhanced VoIP services, including fully hosted IP/PBX services, IP trunking, call center applications, prepaid services, and customized VoIP solutions for specialized applications. In May 2009, the Company obtained its first account on the enhanced platform consisting of a VoIP network to 154 cities for a Fortune 500 company. The network provided includes an interactive voice response auto attendant, call recording, simultaneous calling, voicemail to email conversion, and multiple other IP/PBX features in a hosted environment.

- Commenced a rigorous effort to improve call quality and the average call duration ("ACD") of calls processed on our network. These measures included eliminating underperforming vendors and streamlining routes offered to our customers. As of July 31, 2009, the Company had eliminated 35 underperforming vendors from its global routing, representing 20% of its vendors. In addition, individual routes on which call statistics fell to unacceptable levels, the Company blocked VoIP traffic. These actions resulted in a 55% improvement in ACD year over year.

Voice over Internet Protocol Networks

The basic technology of traditional telecommunications systems was designed for slow mechanical switches. Communications over the traditional telephone network are routed through circuits that must dedicate all circuit 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 to its destination and they automatically route packets around blockages, congestion or outages.

Packet switching 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". A VoIP network has the following advantages over traditional networks:

- Integration of Voice and Data: VoIP networks allow for the integration and transmission of voice, data, and images using the same network equipment.

- Simplification: An integrated infrastructure that supports all forms of communication allows more standardization, a smaller equipment complement, and less equipment management.

- 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 bandwidth. 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: 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 over 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, and new software algorithms and improved hardware have substantially reduced delays in packet transmissions and resulted in better sound quality. 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 acquire and deploy on their own. As a result, many companies use a network consisting of 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 Systems, Inc. has 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 to or 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. Our competitors include major telecommunications carriers in the U.S., foreign telecommunications carriers (which may be owned by foreign governments), and numerous small competitors. 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, coverage, customer service, technical response times, reliability, and network size/capacity. The competitive landscape is rapidly altering the number, identity and competitiveness of the marketplace, and we are unable to determine with certainty the impact of potential consolidation in our industry.

A number of large long distance carriers have introduced services that make Internet telephony or voice services over the Internet available to other carriers. All major telecommunications companies either presently do or could route traffic to destinations worldwide and compete directly with us. 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. In addition, Internet service providers and other 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 migrate into the Internet telephony market as direct competitors.

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.

Our strategy is to take advantage of the increasing demand for international communication services and the global shift from the traditional circuit switched network to the Internet for transporting voice traffic. We target traditional telephone companies migrating towards voice over Internet protocol ("VoIP") and emerging VoIP service providers seeking reliable and competitively priced worldwide routes. We are also capitalizing on the continued global trend of demonopolization of foreign telecommunications markets. Historically, telecommunication services in most foreign countries have been provided by state-run companies, operating as a legal or de facto monopoly. Although these companies historically failed to satisfy the demand for services in their countries, the regulatory scheme effectively precluded competition by foreign carriers. As the demonopolization trend continues in the telecommunications industry throughout the world, many foreign countries are in various stages of migration toward a competitive, multi-carrier market. This has created an opportunity for emerging operators, that typically "leap frog" to the most recent VoIP technology, to enter their respective market.

Our global strategy also benefits from the continued growth in immigration to the United States from foreign countries such as Mexico, Philippines and India. In addition U.S. based corporations expanding globally to decrease labor costs has contributed to the increased demand for global communication services.

The worldwide demand for telecommunications services has been strengthened by:

- An expanding global market for voice communications growing at approximately 10% per year
- Deregulation and demonopolization of government-owned telecommunication companies in foreign countries
- Global proliferation of communications devices such as mobile and VoIP phones
- Growth in ethnic communities in the United States; approximately 90 million people belong to an ethnic minority group
- Increase in global trade and travel
- Declining rates for communication services as a result of increased competition

We operate through our wholly owned subsidiary, Digerati Networks, Inc., a premier global VoIP carrier providing international communication services that consist primarily of transporting voice traffic across the world via the Internet. Digerati owns and operates its own VoIP network in San Antonio, Texas for processing voice communication traffic between the United States and rapidly expanding markets in Asia, Europe, the Middle East, and Latin America.

Through Digerati, we have established numerous partnerships with foreign carriers and network operators to provide our international voice services. In our VoIP operations, Digerati receives voice traffic from originating carriers who are interconnected to its network via the Internet and routes that traffic over the Internet to local service providers and carriers in the destination countries with whom the Company has agreements or partnerships to manage the completion of the call. Our global VoIP service enables carriers and other communications service providers to outsource international voice and fax traffic.

Our customers, while cost conscious, are increasingly demanding high reliability and quality in service delivery. Sustainability and growth in this segment depends on specific competitive advantages including foreign partnerships or presence of an in-country business infrastructure, network reliability, and favorable termination agreements for voice traffic. We compete with other telecom operators, including dominant providers such as Qwest, IBASIS, and AT&T, for transport and termination of international voice services. We believe that our low cost of operations, international relationships, and cost competitive strategy utilizing VoIP technology provides us with a competitive advantage. Our strengths include our in-depth knowledge of, and relationships within, the telecommunications industry in the United States and select foreign markets.

We recently installed a technology platform developed by NetSapiens, Inc. that allows us to offer additional VoIP applications including IP/PBX services, IP trunking, prepaid calling, call center applications, conferencing, messaging and other innovative IP telephony functionality necessary to offer standard and/or custom services to the Residential and Enterprise markets. We are currently marketing these new VoIP services to potential customers through established channel partners that includes data network providers, value added resellers, telecom operators, and wireless Internet service providers. Our strategy is to enable our channel partners to provide specialized VoIP services to their established base of customers, thus creating an additional source of revenue for us and our channel partner. In May 2009, we secured our first customer on the NetSapiens technology platform consisting of a VoIP network to 154 cities for a Fortune 500 company. The network provided includes an interactive voice response auto attendant, call recording, simultaneous calling, voicemail to email conversion, and multiple other IP/PBX features in a hosted environment.

Due to the potential cost savings and added features of VoIP, consumers, enterprises, traditional telecommunication service providers and cable television providers view VoIP as the future of telecommunications. This is accelerating the migration from traditional telephone service to VoIP services. The recent growth in VoIP services is primarily due to:

- Demand for a lower cost alternative to traditional telephone service;
- Improved quality and reliability of VoIP calls due to technological advances, increased network development and greater bandwidth capacity; and
- New product innovations that can be provided by VoIP services providers, but not currently offered by traditional telephone companies.

A recent report published by In-Stat, a market research firm, suggested that revenue in the United States from VoIP business services such as those we can now provide with our NetSapiens platform grew from $485 million in 2007 to a forecasted $1.4 billion in 2009.

Government Regulation

Our operations are subject to federal, state and foreign laws and regulations. There is significant uncertainty regarding the application of the Communications Act of 1934 and the regulations adopted by the Federal Communications Commission to Internet telephone and there is a risk that either the FCC or Congress will impose common carrier restrictions and other requirements of traditional telecommunications providers to providers of VoIP services.

U.S Federal and State Regulation of Carrier Services

We believe that, under U.S. law, the Internet-related services that we provide constitute information services as opposed to regulated telecommunications services, and, as such, are not currently regulated as telecommunications common carriers by the Federal Communications Commission (FCC) or state agencies charged with regulating telecommunications carriers. Nevertheless, aspects of our operations may be subject to state or federal regulation, including regulations governing universal service funding, disclosure of confidential communications and excise tax issues. We cannot provide assurances that Internet-related services will not be actively regulated in the future. Several efforts have been made in the U.S. to enact federal legislation that would either regulate or exempt from regulation services provided over the Internet. Increased regulation of the Internet may slow its growth, particularly if other countries also impose regulations. Such regulation may negatively impact the cost of doing business over the Internet and materially adversely affect our business, operating results, financial condition and future prospects.

To date, the FCC has declined to classify VoIP providers as telecommunications carriers for regulatory purposes. However, the FCC has ruled that certain traffic carried in part utilizing the Internet protocol format was nonetheless regulated telecommunications for which certain regulatory obligations applied. The FCC has considered whether to impose surcharges or other common carrier regulations upon certain providers of Internet telephony, primarily those which, unlike us, provide Internet telephony services directly to end users. The FCC ruled that interconnected VoIP service providers must make contributions to the Universal Service Fund. Additionally, the FCC has a pending proceeding to further examine the question of whether certain forms of VoIP services are information services or telecommunications services. The two are treated differently in several respects, with certain information services being regulated to a lesser degree. The FCC has noted that certain forms of phone-to-phone VoIP services bear many of the same characteristics as more traditional voice telecommunications services and lack the characteristics that would render them information services. The FCC has indicated that the issues as to applicability of access charges and other matters will be considered in that context. Adverse rulings or rulemakings could subject us to licensing requirements and additional fees and subsidies.

If the FCC were to determine that certain Internet-related services including Internet telephony services are subject to FCC regulations as telecommunications services, the FCC could subject providers of such services to traditional common carrier regulation, including payment of access charges to local telephone companies. A decision to impose such charges could also have retroactive effect. It is also possible that the FCC may adopt a regulatory framework other than traditional common carrier regulation that would apply to Internet telephony providers. Any such determinations could materially adversely affect our business, financial condition, operating results and future prospects to the extent that any such determinations negatively affect the cost of doing business over the Internet or otherwise slow the growth of the Internet.

Other regulations affecting the Internet in the United States.

Congress has enacted legislation that regulates certain aspects of the Internet, including online content, user privacy and taxation. In addition, Congress and other federal entities are considering other legislative and regulatory proposals that would further regulate the Internet. Congress has, for example, considered legislation on a wide range of issues including Internet spamming, database privacy, gambling, pornography and child protection, Internet fraud, privacy and digital signatures. Various states have adopted and are considering Internet-related legislation. Increased U.S. regulation of the Internet may slow its growth, particularly if other governments follow suit, which may negatively impact the cost of doing business over the Internet and materially adversely affect our business, financial condition, results of operations and future prospects. Legislation has also been proposed that would clarify the regulatory status of VoIP service. The Company has no way of knowing whether legislation will pass or what form it might take.

Domestic Service Regulation.

We are considered a non-dominant domestic interstate carrier subject to minimal regulation by the FCC. We are not required to obtain FCC authority to initiate or expand our domestic interstate operations, but we are required to obtain FCC approval to transfer control or discontinue service and to file various reports and pay various fees and assessments. Among other things, interstate common carriers must offer service on a nondiscriminatory basis at just and reasonable rates. In addition, as a non-dominant carrier, we are subject to the FCC’s complaint jurisdiction.

All interstate telecommunications carriers are required to contribute to the federal universal service programs. The FCC currently is considering revising its universal service funding mechanism. We cannot predict the outcome of these proceedings or their potential effect on us. Although we currently do not provide VoIP services to the end users or consumers, VoIP services that we may provide in the future are not currently subject to direct regulation by the FCC or state regulatory commissions to the extent that they qualify as "enhanced" or "information" services. The FCC defines enhanced services as services that (1) employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information, (2) provide the subscriber additional, different or restructured information, or (3) involve subscriber interaction with stored information. In 1998, in a non-binding report, the FCC observed that "computer-to-computer" VoIP may be appropriately considered to be unregulated but that "phone-to-phone" VoIP may lack the characteristics that would render them unregulated "information" services. In February 2004, the FCC ruled that free computer-to-computer VoIP service is not "telecommunications service" and that it is an interstate "information service." Although this order clarifies some of the relevant VoIP issues, the FCC has not yet issued a formal decision as to whether other variations of VoIP services should be subject to traditional common carrier telecommunications service regulation, such as access charge obligations. In March 2004, the FCC released a Notice of Proposed Rulemaking ("NPRM") regarding VoIP service. The NPRM specifically addresses the regulatory classification and jurisdiction of VoIP; the application of access charges; and how to preserve key public policy objectives such as universal service, 911/emergency services, law enforcement surveillance requirements, and the needs of persons with disabilities. In November 2004, the FCC ruled that services provided by a particular VoIP provider are interstate in nature, and not subject to entry regulations of the various state Public Service Commissions. The FCC, however, declined to rule on whether the service is a regulated telecommunications service or an unregulated information service. In addition, in December 2004, the United States Court of Appeals for the 8th Circuit ruled that such VoIP provider's service is not subject to state regulation. Subsequently, in a series of orders, the FCC has decided to apply universal service, 911/emergency services, law enforcement surveillance requirements, customer privacy requirements, and requirements relating to the provision of services to speech and hearing-impaired persons to providers of "interconnected" VoIP services (i.e., those that are capable of both originating calls from and terminating calls to users of the public switched telephone network), but in each case the FCC has explicitly declined to decide whether such services are "telecommunications" services subject to more comprehensive regulation. Instead, the FCC continues to examine the appropriate regulatory treatment of VoIP on a piecemeal basis. While initial indications from the FCC suggest that regulation of VoIP will be limited in nature, the future regulatory treatment of other variations of VoIP by the FCC and state regulatory bodies continues to be uncertain. Furthermore, Congressional dissatisfaction with the FCC's treatment of IP telephony could result in legislation requiring the FCC to impose greater or lesser regulation. Changes to, and further clarifications of, the treatment of VoIP services could result in the imposition of burdensome regulation and fees on some of our services and/or increase certain of our operating costs.

International Regulation

The regulatory treatment of Internet telephony outside of the U.S. varies widely from country to country. A number of countries that currently prohibit competition in the provision of voice telephony also prohibit Internet telephony. Other countries permit but regulate Internet telephony. Some countries will evaluate proposed Internet telephony service on a case-by-case basis and determine whether it should be regulated as a voice service or as another telecommunications service. In many countries, Internet telephony has not yet been addressed by legislation or regulation. Increased regulation of the Internet and/or Internet telephony providers or the prohibition of Internet telephony in one or more countries could materially adversely affect our business, financial condition, operating results and future prospects.

The International Settlements Policy governs settlements between U.S. carriers' and foreign carriers' costs of terminating traffic over each other's networks. The FCC recently enacted certain changes in 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 competitors to terminate traffic in the United States and are contributing to the downward pricing pressure facing us in the carrier market.

Other General regulations

Congress has recently enacted legislation that regulates certain aspects of the Internet, including online content, user privacy and taxation. In addition, Congress and other federal entities are considering other legislative and regulatory proposals on a wide range of issues including Internet spamming, database privacy, gambling, pornography and child protection, Internet fraud, privacy and digital signatures. Various states have adopted and are considering Internet-related legislation. Increased U.S. regulation of the Internet may slow its growth, particularly if other governments follow suit, which may negatively impact the cost of doing business over the Internet and materially adversely affect our business, financial condition, results of operations and future prospects. The Company has no way of knowing whether legislation will pass or what form it might take.

The Telecommunications Act of 1996 (the "Telecom Act"), 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. The FCC has now granted such in-region long distance authorization to BOCs throughout the nation. Given their extensive resources and established customer bases, the entry of the BOCs into the long distance market, specifically the international market, has created increased competition for us.

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 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 these 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 downward pricing pressure facing us in the carrier market.

Concession License

The Secretaría de Comunicaciones y Transportes and Comisión Federal de Telecomunicaciones or Federal Telecommunications Comisión ("COFETEL") issued ATSICOM a 30-year license in June 1998 to install and operate a public network. Under this license, ATSICOM is required to:

General requirements

- Maintain approximately $10 million in registered and subscribed capital.
- Install and operate a network in Mexico according to an operating plan approved by the Mexican government..
- Continuously develop and conduct training programs for its staff.
- Designate an individual responsible for the technical functions to operate the concession.

Concession services requirements

- Provide continuous and efficient services at all times to its customers.

- Establish a complaint center and correction facilities center and report to the Mexican government on a monthly basis the complaints received and the actions taken to resolve the problems.

Tariff Requirements

- Invoice its customer only tariffs rates that have been approved by the Mexican government.

Verification and Information requirements

- Provide audited financial statements on a yearly basis that include a detailed description of the fixed assets utilized in the network and reporting by region and location of where the services are being provided.
- 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.
- Provide statistical reports of traffic, switching capacity and other parameters in the network.

Guarantee requirements

- Post a bond/insurance policy for approximately $500,000 payable to the Mexican Federal Treasury Department in the event the concession is revoked for failure to perform any of the requirements.

Under this concession, we have the right to terminate voice and data communications in Mexico. The revocation or modification of this concession would not have a material adverse effect on our business.

Customers and Suppliers

We rely on various suppliers to provide services in connection with our communication services. We use various global VoIP companies to complete our voice over Internet (VoIP) traffic between US, Mexico, Asia, the Middle East and Latin America. We are not dependent upon any single supplier.

Employees

As of July 31, 2009, we had eleven 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.

ITEM 1A. RISK FACTORS.

Our business is subject to various operational and financial risks that could have an adverse effect on our financial condition or our results of operations. In addition the general economic risks associated with operation of a small company in a regulated industry dominated by large well-financed competitors, some of the risk factors that may apply specifically to us are set forth below.

Our results of operations fluctuate from period to period. Our revenue and results of operations have fluctuated and will continue to fluctuate from quarter to quarter in the future due to a number of factors over which we have no control, including:

- Many of our customers are not obligated to route a minimum amount of traffic over our system and the amount of traffic we handle may decline if our customers elect to route traffic over systems they operate or systems operated by other providers;

- increased competition from other telecommunication service providers or from service companies in related fields that offer telecommunication services may adversely affect the amount we can charge for traffic routed over our system;
- we may be required to reduce our charges for routing traffic to maintain high utilization of our equipment;
- the termination fees, connection fees and other charges from our suppliers;
- fraudulently sent or received traffic for which we are obligated to pay but which we are unable to bill to any customer;
- changes in call volume among the countries to which we complete calls;
- technical difficulties or failures of our network systems or third party delays in expansion or provisioning system components; and
- our ability to manage our traffic on a constant basis so that routes are profitable.

We rely on third parties to provide and maintain the networks over which we transmit traffic. Our business model depends on the availability of the Internet and traditional telephone networks to transmit voice and data. Third parties own and maintain the equipment that translates calls from traditional voice networks to the Internet and vice versa. If the owners of these systems fail to maintain their lines properly, fail to maintain the ability to terminate calls, or otherwise disrupt our ability to provide service to our customers, our ability to complete calls or provide other services could be interrupted.

Our suppliers could increase the cost of services they provide or deny us access to systems that they operate. We maintain relationships with communications service providers in many countries and with other carriers to carry traffic on their systems. There is no assurance that these services will continue to be available to us on acceptable terms, if at all. If we are unable to replace any provider that ceases to provide services to us on acceptable terms, or to identify and develop relationships with new service providers, our ability to provide services in certain countries may be adversely affected.

We are subject to downward pricing pressures and a continuing need to renegotiate overseas rates. As a result of numerous factors, including increased competition and global deregulation of telecommunications services, prices for international long distance calls have been decreasing. This downward trend of prices to end-users has caused us to lower the prices we charge communication service providers for call completion on our network. If this downward pricing pressure continues, we may not be able to offer VoIP services at costs lower than, or competitive with, the traditional voice network services with which we compete. Moreover, in order for us to lower our prices, we have to renegotiate rates with our foreign service providers who complete calls for us. We may not be able to renegotiate these terms favorably enough, or fast enough, to allow us to continue to offer services in a particular country on a cost-effective basis. The continued downward pressure on prices and our inability to renegotiate favorable terms in a particular country could have a material adverse effect on our ability to operate our network.

We are subject to risks relating to operations in foreign countries. Because we provide many of our services internationally, we are subject to additional risks related to providing services into foreign countries. Associated risks include:

- unexpected changes in tariffs, trade barriers and regulatory requirements relating to Internet access or VoIP;
- economic weakness, including inflation, or political instability in particular foreign economies and markets;
- difficulty in collecting accounts receivable;
- tax, consumer protection, telecommunications, and other laws;
- foreign currency fluctuations, which could result in increased operating expenses and reduced revenues; and
- unreliable government power to protect our rights;

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International governmental regulation and legal uncertainties and other laws could limit our ability to provide our services, make them more expensive, or subject us to legal liability. Many countries currently prohibit or limit competition in the provision of traditional voice telephony services. In some of those countries, licensed telephony carriers as well as government regulators and law enforcement authorities have questioned the legal authority of VoIP services. Our failure to qualify as a properly licensed service provider, or to comply with other foreign laws and regulations, could materially adversely affect our business, financial condition, and results of operations. It is also possible that countries may apply to our activities laws relating to services provided over the Internet, including laws governing:

- user privacy;
- pricing controls and termination costs;
- characteristics and quality of products and services;
- qualification to do business;
- consumer protection;
- cross-border commerce, including laws that would impose tariffs, duties and other import restrictions;
- copyright, trademark and patent infringement; and
- claims based on the nature and content of Internet materials, including defamation, negligence and the failure to meet necessary obligations.

If foreign governments or other bodies begin to impose related restrictions on VoIP or our other services or otherwise enforce other laws against us or our foreign suppliers, such actions could have a material adverse effect on our operations.

If we are not able to keep up with rapid technological change in a cost-effective way, the relative quality of our services could suffer. The technology upon which our services depend is changing rapidly. Significant technological changes could render the hardware and software that we use obsolete, and competitors may begin to offer new services that we are unable to offer. If we are unable to respond successfully to these developments or do not respond in a cost-effective way, we may not be able to offer competitive services and our business results may suffer.

We may not be able to expand and upgrade our network adequately and cost-effectively to accommodate any future growth. Our VoIP business requires that we handle a large number of international calls simultaneously. As we expand our operations, we expect to handle significantly more calls. If we do not expand and upgrade our hardware and software quickly enough, we will not have sufficient capacity to handle the increased traffic and growth in our operating performance would suffer as a result. Even with such expansion, we may be unable to manage new deployments or utilize them in a cost-effective manner. In addition to lost growth opportunities, any such failure could adversely affect customer confidence in our network and services.

Single points of failure on our network may make our business vulnerable. We operate one network control center in San Antonio, Texas. We have not yet designed a redundant system, provided for excess capacity, or taken other precautions against platform and network failures as well as facility failures relating to power, air conditioning, destruction, or theft. We are vulnerable to a network failure that may prohibit us from offering services.

We depend on our current personnel and may have difficulty attracting and retaining the skilled employees we need to execute our business plan. Our future success will depend, in large part, on the continued service of our key management and technical personnel. If any of these individuals or others we employ are unable or unwilling to continue in their present positions, our business, financial condition and results of operations could suffer.

If the Internet infrastructure is not adequately maintained, we may be unable to maintain the quality of our services and provide them in a timely and consistent manner. Our future success will depend upon the maintenance of the Internet infrastructure, including a reliable network backbone with the necessary speed, data capacity and security for providing reliability and timely Internet access and services. To the extent that the Internet continues to experience increased numbers of users, frequency of use or bandwidth requirements, the Internet may become congested and be unable to support the demands placed on it and its performance or reliability may decline thereby impairing our ability to complete calls and provide other services using the Internet at consistently high quality. The Internet has experienced a variety of outages and other delays as a result of failures of portions of its infrastructure or otherwise. Future outages or delays could adversely affect our ability to complete calls and provide other services. Moreover, critical issues concerning the commercial use of the Internet, including security, cost, ease of use and access, intellectual property ownership and other legal liability issues, remain unresolved and could materially and adversely affect both the growth of Internet usage generally and our business in particular. Finally, important opportunities to increase traffic on our network will not be realized if the underlying infrastructure of the Internet does not continue to be expanded to more locations worldwide.

Vulnerability of the Internet to malicious activity. The Internet, and certain components thereof, is susceptible to malicious damage or destruction by the creation and distribution of software designed to interrupt of corrupt the transmission of data, by concerted efforts to cause congestion, and other malicious activities. If such activities are successful in interrupting the transmission of data between our network and the destination of the transmission, it could have an adverse effect on client confidence in our ability to maintain a stable and reliable network. Since we do not control access to the servers, gateways, and other components of the Internet that are used to transmit traffic, we are not able to protect such components from attack.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not Applicable

ITEM 2. PROPERTIES.

Our executive office is located at 3201 Cherry Ridge, Building C, Suite 300, San Antonio, Texas, in leased space consisting of 3,618 square feet. The lease for this facility will expire on November 15, 2011. We pay annual rent of $50,937. We believe that our leased facilities are suitable and adequate for their intended use.

ITEM 3. LEGAL PROCEEDINGS.

The company is a defendant in CHRISTIAN & SMITH, LLP and JOHN M. O'QUINN & ASSOCIATES, LLP vs. ATSI COMMUNICATIONS, INC. filed on December 12, 2008 in the 133rd Judicial District of Harris County, Texas. The plaintiffs claim that the company is responsible for the payment of contingent fees in connection with a suit filed by the plaintiffs as the company’s lawyers against The Shaar Fund. The company has denied any liability for the contingent fees because the case filed against The Shaar Fund was dismissed without recovering any damages. This case has been dormant since it was filed and no discovery has been taken. On April 15, 2009, the Court ordered a six-month abatement of the case. The company intends to vigorously defend this matter but cannot determine the likelihood of an adverse outcome or the range of potential loss.

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

None

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Market for Common Equity

Our common stock is quoted on the OTC Bulletin Board under the symbol “ATSX”. The following table sets forth the high and low bid prices for our common stock for the two most recently completed fiscal years, as reported by Bloomberg, LP. Price quotations on the OTC Bulletin Board reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not necessarily represent actual transactions.

Fiscal 2008	Low	High
First Quarter	$ 0.20	$ 0.30
Second Quarter	$ 0.17	$ 0.28
Third Quarter	$ 0.15	$ 0.23
Fourth Quarter	$ 0.16	$ 0.24

Fiscal 2009	Low	High
First Quarter	$ 0.13	$ 0.23
Second Quarter	$ 0.07	$ 0.15
Third Quarter	$ 0.04	$ 0.08
Fourth Quarter	$ 0.04	$ 0.06

Holders

As of July 31, 2009 we had approximately 8,206 common stockholders.

Dividends

We have not paid cash dividends on our common stock and we do not anticipate paying a dividend in the future.

Equity Compensation Plans

The following table provides information regarding securities that have been or are authorized to be issued under our equity compensation plans as of July 31, 2009:

	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
Equity Compensation plans approved by security holders	-0-	N/A	-0-
Equity Compensation Plans not approved by security holders	8,239,000	$ .04	9,261,000
Total	8,239,000	$ .04	9,261,000

The material features of each equity compensation plan are described in Note 10 of the Notes to the Financial Statements.

Sales of Unregistered Securities

During the period covered by this report, the Company issued 5,611,962 shares of our common stock to our employees for services rendered. The shares were issued without registration pursuant to Section 4(2) of the Securities Act because of the existing relationship with the individuals to whom the shares were listed.

ITEM 6. SELECTED FINANCIAL DATA.

Not Applicable

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

SPECIAL NOTE: This Annual Report on Form 10-K 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."or words of similar import Although we believe these expectations are reasonable our operations involve a number of risks and uncertainties, including those listed in Item 1A of this Annual Report on Form 10-K and actual results may be materially different than our expectations.

The following is a discussion of the consolidated financial condition and results of operations of ATSI Communications, Inc., for the fiscal years ended July 31, 2009 and 2008. 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. For purposes of the following discussion, fiscal 2009 or 2009 refers to the year ended July 31, 2009 and fiscal 2008 or 2008 refers to the year ended July 31, 2008.

Sources of revenue and direct cost

Sources of revenue:

VoIP Services: We currently provide VoIP communication services to U.S. and foreign telecommunications companies that lack transmission facilities, require additional capacity or do not have the regulatory licenses to terminate traffic in Mexico, Asia, the Middle East and Latin America. Typically, these telecommunications companies offer their services to the public for domestic and international long distance services

Network Services: We provide private communication links and VoIP gateway services to multi-national and foreign carriers and enterprise customers who require a high volume of telecommunications services to communicate with their U.S. offices or businesses and need greater dependability than is currently available through the foreign telecommunication networks. These services include data, voice and fax transmission between multiple international offices and branches as well as Internet and co-location services in the United States.

Direct Costs:

VoIP Services: We incur transmission and termination charges from our suppliers and the providers of the infrastructure and network. The cost is based on rate per minute, volume of minutes transported and terminated through the network. Additionally, we incur fixed Internet bandwidth charges and per minute billing charges. In some cases we incur installation charges from certain carriers. These installation costs are passed on to our customers for the connection to our VoIP network.

Network Services: We incur bandwidth and co-location charges in connection with Network Services. The bandwidth 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. We also incur co-location charges that are passed through to our customers.

Results of Operations

The following table sets forth certain items included in our results of operations in thousands of dollars amounts and variances between periods for the years ended July 31, 2009 and 2008.

Year Ended July 31, 2009 Compared to Year ended July 31, 2008

	Years ended July 31, 2009	2008	Variances	%
OPERATING REVENUES:				
VoIP services	$ 19,891	$ 41,961	$ (22,070)	-53%
Total operating revenues	19,891	41,961	(22,070)	-53%
Cost of services (exclusive of depreciation and amortization, shown below)	18,533	38,884	(20,351)	-52%
GROSS MARGIN	1,358	3,077	(1,719)	-56%
Selling, general and administrative expense (exclusive of legal and professional fees)	2,157	2,400	(243)	-10%
Legal and professional fees	353	352	1	0%
Bad debt expense	2	(27)	29	-107%
Depreciation and amortization expense	152	160	(8)	-5%
OPERATING INCOME (LOSS)	(1,306)	192	(1,498)	-780%
OTHER INCOME (EXPENSE):				
Gain on early extinguishment of debt	108	41	67	163%
Loss attributed to noncontrolling interest	(114)	-	(114)	-100%
Minority Interest	-	(16)	16	-100%
Interest income (expense)	(196)	(105)	(91)	87%
Total other income (expense), net	(202)	(80)	(122)	153%
NET INCOME (LOSS)	(1,508)	112	(1,620)	-1446%
LESS: PREFERRED DIVIDEND	-	(12)	12	-100%
ADD: REVERSAL OF PREVIOUSLY RECORDED PREFERRED DIVIDEND	-	340	(340)	-100%
NET INCOME (LOSS) TO COMMON STOCKHOLDERS	$ (1,508)	$ 440	$ (1,948)	-443%

Operating Revenues. VoIP services revenue decreased by $22,070,000, or 53%, from the fiscal year ended July 31, 2008 to the fiscal year ended July 31, 2009. VoIP minutes carried by our network on which we generated revenues decreased by 31% from approximately 564,064,005 minutes of voice traffic during the year ended July 31, 2008 to approximately 391,925,140 minutes of voice traffic during the year ended July 31, 2009. Additionally, our average revenue per minute (ARPM) decreased by 32% from $0.0742 during the year ended July 31, 2008 to $0.05068 for the year ended July 31, 2009. During the second quarter of FY2009, we began a rigorous effort to increase traffic quality and the average call duration (ACD) of calls processed by our network. These measures included eliminating and streamlining many of the routes offered. This contributed to a decrease of approximately 20% in the number of vendors connected to our network. Despite the decline in revenue and the total number of minutes processed by our network, our efforts to streamline the routes we offer and eliminate certain routes resulted in an increase in average call duration (ACD) from 2.45 minutes per call for the year ended July 31, 2008 to 4.00 minutes for the year ended July 31, 2009 and partially offsetting the fewer number of calls that were completed through our network during the year ended July 31, 2009. The declines in both the total minutes processed by our network and the average revenue per minute (ARPM) are the direct result of the lower level of international calling during the current global economic recession. We believe that the decision made during the second quarter of Fiscal 2009 to streamline our routes and eliminate under performing and inefficient routes will positively influence our business in the long term, as evidenced by the continued increase in the average call duration. We expect the increase in ACD to have a favorable impact on our total revenues as the number of completed calls processed through our networks return to normal levels since each completed call will represent a larger number of minutes processed.

Cost of Services (exclusive of depreciation and amortization). The consolidated cost of services decreased by $20,351,000, or 52%, from the year ended July 31, 2008 to the year ended July 31, 2009. The decrease in cost of services is a direct result of the decrease in VoIP services revenue. Cost of services, as a percentage of revenue increased slightly between periods, from 92.67% of revenue during the year ended July 31, 2008 to 92.89% of revenue during the year ended July 31, 2009. The increase in cost of services as a percentage of revenue is a result of increases received from our vendors during the period. As a result of the decrease in VoIP revenues, our gross margin declined by $1,719,000 or 54% to $1,358,000 for the year ended July 31, 2009 compared to $3,077,000 for the year ended July 31, 2008.

Selling, General and Administrative (SG&A) Expenses (exclusive of legal and professional fees). SG&A expenses decreased by $243,000, or 10%, from the year ended July 31, 2008 to the year ended July 31, 2009. The decrease is primarily attributable to the decrease in non-cash compensation expense to employees. During the year ended July 31, 2008 we recognized $695,000 in non-cash compensation expense to employees. In comparison, we only recognized $389,000 in non-cash compensation expense to employees during the year ended July 31, 2009.

Legal and Professional Fees. Legal and professional fees were comparable between periods at approximately $353,000. During both fiscal years our legal and professional fees were composed of fees to our Auditors and attorneys for matters related to our reporting requirements, legal fees as part of the normal course of business and litigation.

Bad debt expense. Bad debt expense increased by $29,000, or 107%, from the year ended July 31, 2008 to the year ended July 31, 2009. During the year ended July 31, 2008 we recognized an adjustment in bad debt of $27,000 as a result of changes in the VoIP market and historical uncollectible accounts. We did not incur similar adjustment during the year ended July 31, 2009.

Depreciation and Amortization. Depreciation and amortization decreased by $8,000 or 5%, from the year ended July 31, 2008 to the year ended July 31, 2009. The reduction in depreciation expense is as a result of some of the equipment and software reaching its depreciable value, thus the decrease between periods.

Operating Income (loss). Our operating loss increased by $1,498,000, or 780%, from the year ended July 31, 2008 to the year ended July 31, 2009. The increase in operating loss between periods is attributed to the decrease in gross margin, which was slightly offset by the decrease between periods in SG&A expenses and depreciation expense.

Other Income (expense). Other expense during the year ended July 31, 2009 included a gain on early extinguishment of debt of $108,000, which was attributed to a discount of $108,000 recognized as a result of the settlement of the promissory note with The Shaar Fund. However, the gain was offset by the increase in interest expense of $91,000, or 87%, from $105,000 for the year ended July 31, 2008 to $196,000 for the year ended July 31, 2009. The increase is attributed to the additional interest expense incurred as a result of the new promissory notes with various holders for $850,000 and a promissory note with San Antonio National Bank for $425,000.

Net Income (loss). Net loss increased by $1,620,000 or 1,446%, from the year ended July 31, 2008 to the year ended July 31, 2009. The increase in net loss between periods is attributed to the decrease between periods in operating income and the increase between periods in other expenses.

Preferred Stock Dividends. Preferred stock dividends decreased by $12,000, or 100%, between periods, from $12,000 for the year ended July 31, 2008 to $0 during the year ended July 31, 2009. The decrease in preferred dividends between periods is mainly attributed to a decrease in dividends associated with Series A Convertible Preferred Stock and Series D Convertible Preferred Stock, none of which were outstanding during the year ended July 31, 2009

Reversal of Previously Recorded Preferred Stock Dividends. During the year ended July 31, 2008, we recognized a reversal of previously recorded dividend expense of $340,000. This reversal occurred as result of the settlement agreement reached with The Shaar Fund. Under the settlement agreement, the Shaar Fund agreed to surrender 742 shares of our 6% Series D Cumulative Convertible Preferred Stock and forgive accrued dividends of approximately $340,000 as of October 24, 2007. We did not recognize any reversals of previously recorded preferred stock dividends during the year ended July 31, 2009

Net loss Applicable to Common Stockholders. Net loss applicable to common stockholders increased by $1,948,000, or 443%, from the year ended July 31, 2008 to the year ended July 31, 2009. The increase in net loss between periods is attributed to the decrease between periods of $1,719,000 in gross margin and the increase of $91,000 in interest expense. Additionally, during the year ended July 31, 2008 we recognized a reversal of previously recorded preferred dividend of $340,000. We did not recognize this type of reversal during the year ended July 31, 2009. The decrease in the reversal of previously recorded preferred divided was slightly offset by the decrease of $306,000 in non-cash compensation expense to employees and a decrease between periods of $67,000 in gain on early extinguishment of debt as a result of the settlement of a promissory note.

Liquidity and Capital Resources

Cash Position: We had a cash balance of $637,000 as of July 31, 2009. Net cash consumed by operating activities during the year ended July 31, 2009 was approximately $1,261,000. Investing activities during the year ended July 31, 2009 consumed $122,000, consisting of an increase of $7,000 associated with investments in certificates of deposit and $115,000 associated with the acquisition of various computers and servers. Financing activities during the year ended July 31, 2009 provided $682,000 in cash. This cash was primarily provided by a $425,000 promissory note payable to San Antonio National Bank and a financing from various note holders for $850,000. The cash received from the various promissory notes was slightly offset by the cash consumed by debt principal payments of $542,000 associated with various notes payable, acquisition of our common stock of $48,000 and principal payments of $3,000 associated with a capital lease obligation. Overall, our net operating, investing and financing activities during the year ended July 31, 2009 consumed $701,000 in our available cash.

We are currently utilizing the cash received from various promissory notes payable for $1,275,000. We believe that this financing will allow us to support our growth during the following fiscal year. Additionally, we are utilizing the factoring agreement with Wells Fargo Bank as necessary to provide cash for operations. Under the agreement we are able to factor up to $5,000,000 of our monthly accounts receivable. On average, we are factoring account receivables of $32,000 per month. As of July 31, 2009 we did not have any outstanding receivables under the Wells Fargo Factoring agreement.

Our current cash expenses are expected to be approximately $150,000 per month, including wages, rent, utilities and corporate professional fees. We are currently using $105,000 in cash generated from operations and approximately $40,000 per month of our available cash to cover all monthly cash expenses. We anticipate that the July 31, 2009 cash balance of $637,000, certificate of deposit of $325,000 combined with expected net cash flow generated from future operations and the factoring agreement with Wells Fargo Bank, will be sufficient to fund our operations and capital asset expenditures for the next twelve months.

Our working capital (deficit) was $574,000 as of July 31, 2009. This represents a decline of approximately $1,001,000 from our working capital at July 31, 2008.

Critical Accounting Policies

Revenue Recognition. We derive our revenue from VoIP Services and Network Services. Revenue is recognized when persuasive evidence of an arrangement exists, service or network capacity has been provided, the price is fixed or determinable, collectibility is reasonably assured and there are no significant obligations remaining.

We record and report our revenue on the gross amount billed to our customers in accordance with the following “gross indicators” discussed in EITF 99-19:

- ATSI is the primary obligor in its arrangements,

- ATSI has latitude in establishing pricing,

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- ATSI changes the product or performs part of the service and is involved in the determination of the product or service specifications,
- ATSI has discretion in supplier selection; and
- ATSI assumes credit risk for the amount billed to the customer

We recognize revenue from VoIP Services in the period the service is provided, net of revenue reserves for potential billing credits. Such disputes can result from disagreements with customers regarding the duration, destination or rates charged for each call. ATSI recognizes network services revenue during the period the service is provided.

Direct Cost of Revenue. We incur termination charges in connection with providing VoIP services, installation charges connection to the VoIP network of our carriers, and Internet, co-location and fiber optic charges in connection with providing network services. Termination charges, connection charges and other direct costs of revenue are recognized in the period incurred.

Stock-based Compensation. We record compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards No. 123R, “Share-Based Payment”, as interpreted by SEC Staff Accounting Bulletin No. 107. Prior to February 1, 2006, we accounted for stock options according to the provisions of Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees”, and related interpretations, and therefore no related compensation expense was recorded for awards granted with no intrinsic value. We estimate the fair market value of its stock options using the Black Scholes pricing model. We use the following key assumptions in determining the fair market value of its options:

	For the Years Ended July 31,	
	2009	2008
Expected dividends yield	0.00%	0.00%
Expected stock price volatility	126% - 296%	75% - 105%
Risk-free interest rate	2.28% - 3.48%	3.15% - 4.65%
Expected life of options	3.75 - 4.5 years	4 - 6 years

Derivative financial instruments. We do not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks. We evaluate the application of SFAS 133 and EITF 00-19 for all convertible financial instruments and freestanding warrants.

For derivative financial instruments that meet the definition of liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported as charges or credits to income. For option-based derivative financial instruments, we use the Black-Scholes option-pricing model to value the derivative instruments. The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is re-assessed at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

ITEM 7A. QUANTITIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the board of directors and Stockholders
ATSI Communications, Inc.
San Antonio, Texas

We have audited the accompanying consolidated balance sheets of ATSI Communications, Inc. and subsidiaries as of July 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for each of the two years then ended. These consolidated financial statements are the responsibility of ATSI's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (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. ATSI is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ATSI's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ATSI as of July 31, 2009 and 2008 and the consolidated results of their operations and its cash flows for each of the two years then ended in conformity with accounting principles generally accepted in the United States of America.

MALONE & BAILEY, PC
www.malone-bailey.com
Houston, Texas

October 15, 2009

PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	July 31, 2009	July 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 637	$ 1,338
Certificates of deposit	325	-
Accounts receivable, net of allowance for bad debt of $10 and $60, respectively	337	1,082
Notes receivable, related party	-	25
Prepaid & other current assets	77	124
Total current assets	1,376	2,569
LONG-TERM ASSETS:		
Certificates of deposit	-	319
Intangible Assets, net of amortization of $16 and $1, respectively	134	149
PROPERTY AND EQUIPMENT	794	611
Less - accumulated depreciation	(576)	(439)
Net property and equipment	218	172
Total assets	$ 1,728	$ 3,209
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES:		
Accounts payable	$ 585	$ 1,361
Wells Fargo factoring collateral	-	18
Accrued liabilities	192	116
Current portion of obligation under capital leases	-	3
Notes payable, net of unamortized discount of $33 and $0, respectively	1,173	566
Convertible debentures, net of unamortized discount of $0 and $5, respectively	-	78
Total current liabilities	1,950	2,142
LONG-TERM LIABILITIES:		
Notes payable	291	588
Derivative liability	85	-
Convertible debentures, net of unamortized discount of $0 and $3, respectively	-	81
Obligation under capital leases, less current portion	-	1
Other	3	3
Total long-term liabilities	379	673
Total liabilities	2,329	2,815

STOCKHOLDERS' EQUITY (DEFICIT):				
Preferred Stock, 16,063,000 shares authorized, none issued and outstanding		-		-
Common stock, $0.001 par value, 150,000,000 shares authorized, 45,504,120 and 39,550,415 shares				
issued and outstanding, respectively		46		39
Additional paid in capital		73,253		72,747
Noncontrolling interest		(114)		-
Accumulated deficit		(73,787)		(72,393)
Other comprehensive income		1		1
Total stockholders' equity (deficit)		(601)		394
Total liabilities and stockholders' equity (deficit)	$	1,728	$	3,209

See accompanying notes to financial statements

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

	Years ended July 31, 2009	2008
OPERATING REVENUES:		
VoIP services	$ 19,891	$ 41,961
Total operating revenues	19,891	41,961
OPERATING EXPENSES:		
Cost of services (exclusive of depreciation and amortization)	18,533	38,884
Selling, general and administrative expense (exclusive of legal and professional fees)	2,157	2,400
Legal and professional fees	353	352
Bad debt expense	2	(27)
Depreciation and amortization expense	152	160
Total operating expenses	21,197	41,769
OPERATING INCOME (LOSS)	(1,306)	192
OTHER INCOME (EXPENSE):		
Gain on early extinguishment of debt	108	41
Loss attributed to noncontrolling interest	(114)	-
Investment loss	-	(16)
Interest expense	(196)	(105)
Total other expense	(202)	(80)
NET INCOME (LOSS)	(1,508)	112
LESS: PREFERRED DIVIDEND	-	(12)
ADD: REVERSAL OF PREVIOUSLY RECORDED PREFERRED DIVIDEND	-	340
NET INCOME (LOSS) TO COMMON STOCKHOLDERS	$ (1,508)	$ 440
BASIC INCOME (LOSS) PER SHARE TO COMMON STOCKHOLDERS	$ (0.04)	$ 0.01
DILUTED INCOME (LOSS) PER SHARE TO COMMON STOCKHOLDERS	$ (0.04)	$ 0.01
WEIGHTED AVERAGE BASIC COMMON SHARES OUTSTANDING	40,043,303	39,143,748
WEIGHTED AVERAGE DILUTED COMMON SHARES OUTSTANDING	40,043,303	39,197,319

See accompanying notes to financial statements

ATSI COMMUNICATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE YEARS ENDED JULY 31, 2008 AND 2009
(in thousands, except share amounts)

	Preferred (D) Shares	Preferred (D) Par	Preferred (E) Shares	Preferred (E) Par	Common Shares	Common Par	Additional Paid-in Capital	Noncontrolling interest	Accumulated Deficit	Other Comp. Income/Loss	Totals
BALANCE, JULY 31, 2007	742	1	1,170	1	37,620,513	38	$ 72,222	$ -	$ (72,505)	$ 1	$ (242)
Repurchase of Common Shares					(44,002)	-	(10)				(10)
Shares issued for Services					1,448,686	1	348				349
Common shares issued for Preferred Stock Conversion					3,434	-	1				1
Dividends declared							(12)				(12)
Reversal of previously recorded preferred dividend							340				340
Stock option expense							423				423
Shares issued for conversion of notes payable					521,784	-	135				135
Retirement of preferred stock, settlement of lawsuit	(742)	(1)	(1,170)	(1)			(700)				(702)
Net income									112		112
BALANCE, July 31, 2008	-	-	-	-	39,550,415	39	$ 72,747	$ -	$ (72,393)	$ 1	$ 394
Repurchase of common shares					(295,981)	-	(48)				(48)
Stock issued for services to employees					5,611,963	6	219				225
							164				164

Stock option expense											
Shares issued for conversion of notes payable					637,723	1	171				172
Net loss								(114)	(1,394)		(1,508)
BALANCE, July 31, 2009	-	-	-	-	45,504,120	46	$ 73,253	$ (114)	$ (73,787)	$ 1	$ (601)

See accompanying notes to financial statements

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

	Years ended July 31, 2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME (LOSS)	$ (1,508)	$ 112
Adjustments to reconcile net loss to cash used in operating activities:		
Investment loss	-	16
Loss attributed to noncontrolling interest	114	-
Gain on early extinguishment of debt	(108)	(41)
Depreciation and amortization	152	160
Issuance of stock grants and options, employees for services	389	695
Issuance of common stock and warrants for services	-	77
Provisions for losses on accounts receivables	2	(27)
Amortization of debt discount	60	8
Changes in operating assets and liabilities:		
Accounts receivable	609	(238)
Prepaid expenses and other	(21)	(96)
Accounts payable	(1,041)	322
Wells Fargo Factoring Collateral	(18)	-
Accrued liabilities	109	(23)
Net cash (used in) / provided by operating activities	(1,261)	965
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in certificates of deposit	(7)	(13)
Note receivable, related party	-	(25)
Purchase of VoIP License	-	(100)
Purchases of property & equipment	(115)	(25)
Net cash used in investing activities	(122)	(163)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on notes payable	(542)	(251)
Retirement of redeemable preferred stock series D&E	-	(250)
Acquisition of common stock	(48)	(10)
Proceeds from Notes payables	1,275	-
Principal payments on capital lease obligation	(3)	(3)
Net cash provided by / (used in) financing activities	682	(514)
DECREASE IN CASH	(701)	288
CASH AND CASH EQUIVALENTS, beginning of period	1,338	1,050
CASH AND CASH EQUIVALENTS, end of period	$ 637	$ 1,338
SUPPLEMENTAL DISCLOSURES:		
Cash paid for interest	$ 117	$ (62)
Cash paid for income tax	-	-

NON-CASH INVESTING AND FINANCING TRANSACTIONS				
Issuance of common stock for conversion of debt	$	172	$	136
Conversion of preferred stock to common stock		-		1
Preferred stock dividends		-		12
Reversal of previously recorded preferred stock dividend		-		(340)
Put option classified as derivative liability		85		-
Gain from the sale of Telefamilia		-		82
Acquisition of VoIP license, conversion of note receivable		-		150
Acquisition of fixed assets, conversion of prepaid and accounts receivable, respectively		64		50
Note payable, settlement of redeemable preferred stock		-		450

See accompanying notes to financial statements

ATSI COMMUNICATIONS, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business. ATSI Communications, Inc. was incorporated in Nevada on May 24, 2004. ATSI is an international telecommunications carrier that utilizes the Internet to provide economical international communication services to carriers and telephony resellers around the world. ATSI's continuing operations consist of VoIP carrier services and network services. ATSI's primary business consists of providing VoIP communication services to U.S. and foreign telecommunications companies that lack transmission facilities and require additional capacity or do not have the regulatory licenses to terminate traffic in Mexico, Asia, the Middle East and Latin America. ATSI recently installed a VoIP technology platform that allows the Company to offer other VoIP applications including IP/PBX services, IP trunking, prepaid calling, call center applications, conferencing, messaging and other innovative IP telephony functionality.

Principles of Consolidation. The consolidated financial statements include the accounts of the Company, and its subsidiaries, which are either majority owned or controlled by the Company. In accordance with Financial Accounting Standards Board Interpretation No. 46 (Revised) ("FIN46R"), Consolidation of Variable Interest Entities, the Company identifies entities for which control is achieved through means other than through voting rights (a "variable interest entity" or "VIE") and determines when and which business enterprise, if any, should consolidate the VIE. In addition, the Company discloses information pertaining to such entities wherein the Company is the primary beneficiary or other entities wherein the Company has a significant variable interest. All significant intercompany transactions and balances have been eliminated.

Reclassifications. Certain amounts in the consolidated financial statements of the prior year have been reclassified to conform to the presentation of the current year for comparative purposes.

Use of Estimates. In preparing financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheet and revenue and expenses in the statement of expenses. Actual results could differ from those estimates.

Concentration of Credit Risk. Financial instruments that potentially subject ATSI to concentration of credit risk consist primarily of trade receivables. In the normal course of business, ATSI provides credit terms to its customers. Accordingly, ATSI performs ongoing credit evaluations of its customers and maintains allowances for possible losses, which, when realized, have been within the range of management's expectations. ATSI maintains cash in bank deposits accounts, which, at times, may exceed federally insured limits. ATSI has not experienced any losses in such accounts and ATSI does not believe ATSI is exposed to any significant credit risk on cash and cash equivalents.

Revenue Recognition. ATSI derives revenue from two product offerings Carrier Services and Network Services. Revenue is recognized when persuasive evidence of an arrangement exists, service or network capacity has been provided, the price is fixed or determinable, collectibility is reasonably assured and there are no significant obligations remaining.

ATSI records and reports its revenue on the gross amount billed to its customers in accordance with the following indicators in EITF 99-19:

- ATSI is the primary obligor in its arrangements,

- ATSI has latitude in establishing pricing,
- ATSI changes the product or performs part of the service and is involved in the determination of the product or service specifications,
- ATSI has discretion in supplier selection and
- ATSI assumes credit risk for the amount billed to the customer.

VoIP Service: ATSI provides VoIP communication services to U.S. and foreign telecommunications companies, who lack transmission facilities, require additional capacity or do not have the regulatory licenses to terminate traffic in Mexico, Asia, the Middle East and Latin America. Typically these telecommunications companies offer their services to the public for domestic and international long distance services. Carrier service revenue is derived through transporting and terminating minutes of telecommunications traffic over ATSI's owned or leased VoIP network (Voice over Internet Protocol). ATSI recognizes revenue in the period the service is provided, net of revenue reserves for potential billing credits. Such disputes can result from disagreements with customers regarding the duration, destination or rates charged for each call.

Network Services: ATSI provides private communication links and VoIP gateway services to multi-national and foreign carriers and enterprise customers who use a high volume of telecommunications services to communicate with their U.S. offices or businesses and need greater dependability than is currently available through the foreign telecommunication networks. These services include data, voice and fax transmission between multiple international offices and branches as well as Internet and collocation services in the United States. ATSI recognizes network services revenue during the period the service is provided. Currently Network services is less than 0.01% of total revenue.

Direct Cost of Revenue.

VoIP Services: Under carrier services, ATSI incurs termination charges. These charges are related to the fees that ATSI is charged by carriers/vendors for the termination of phone calls into their infrastructure and network to terminate traffic in Mexico, Asia, the Middle East and Latin America. The cost is based on a per minute rate and volume. ATSI also incurs installation charges from various carriers; this cost is passed on to customers for the connection to the VoIP network from ATSI's carriers.

Network Services: Under network services, ATSI incurs Internet, co-location, and fiber optic charges. The Internet 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. Co-location charges are incurred for space utilized to install gateways, servers, and other communications equipment.

Certificates of Deposit.

On July 23, 2009 ATSI purchased a $215,000 certificate of deposit, with a one month maturity and a variable interest rate of return, from Wells Fargo Bank. The certificate of deposit automatically renews on a monthly basis.

On July 9, 2009 ATSI purchased a $110,000 certificate of deposit, with a monthly maturity and a variable interest rate of return, from Wells Fargo Bank. The certificate of deposit is pledged as collateral on a $100,000 promissory note with Wells Fargo Bank. The certificate of deposit automatically renews on a monthly basis.

Allowance for Doubtful Accounts. Bad debt expense is recognized based on management's estimate of likely losses each year based on past experience and an estimate of current year uncollectible amounts. As of July 31, 2009 and 2008, ATSI's allowance for doubtful accounts balance was approximately $10,000 and $60,000, respectively.

Investment in unconsolidated subsidiaries.

ATSI Comunicaciones S.A de C.V., (ATSICOM)

On May 22, 2003 ATSI sold 51% of its interest in ATSI Comunicaciones S.A de C.V., (ATSICOM) As of July 31, 2008, ATSI has a 49% interest in the profits and equity of ATSICOM, a Mexican corporation engaged in providing telecommunication services. During fiscal 2003, ATSI recorded the investment in the unconsolidated subsidiary in conformity with the equity method of accounting. During the year ended July 31, 2004, ATSI determined that the estimated future cash flows expected from the concession license were less than its carrying value. As a result ATSI recorded an impairment loss of approximately $702,000 to reduce the recorded value of the concession license to zero. Although there is no assurance of future value appreciation, from time to time ATSI will conduct a valuation of its investment in the concession license and record the determined value, if any, in its financial statements. As of July 31, 2009, nothing has come to management’s attention that would require ATSI to make any adjustment to its financial statement.

Property and equipment. Property and equipment is recorded at cost. Additions are capitalized and maintenance and repairs are charged to expense as incurred. Gains and losses on dispositions of equipment are reflected in operations. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which are one to five years.

Impairment of Long-Lived Assets. ATSI reviews the carrying value of its long-lived assets annually or whenever events or changes in circumstances indicate that the value of an asset may no longer be appropriate. ATSI assesses recoverability of the carrying value of the asset by estimating the future net cash flows expected to result from the asset, including eventual disposition. If the future net cash flows are less than the carrying value of the asset, an impairment loss is recorded equal to the difference between the asset's carrying value and fair value.

Derivative financial instruments. ATSI does not use derivative instruments to hedge exposures to cash flow, market, or foreign currency risks. ATSI analyzes its convertible instruments and free-standing instruments such as warrants for derivative liability accounting according to Statement of Financial Accounting Standards No. 133 and Emerging Issues Task Force 00-19.

For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported as charges or credits to income. For option-based derivative financial instruments, ATSI uses the Black-Scholes option-pricing model to value the derivative instruments.

The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is re-assessed at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date. There are no derivative instrument liabilities as of July 31, 2009 or 2008, respectively.

Income taxes. ATSI recognizes deferred tax assets and liabilities based on differences between the financial reporting and tax bases of assets and liabilities using the enacted tax rates and laws that are expected to be in effect when the differences are expected to be recovered. ATSI provides a valuation allowance for deferred tax assets for which it does not consider realization of such assets to be more likely than not.

Stock-based compensation. ATSI records compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards No. 123R, Share-Based Payment, as interpreted by SEC Staff Accounting Bulletin No. 107.

Basic and diluted net loss per share. The basic net loss per common share is computed by dividing the net loss by the weighted average number of common shares outstanding. Diluted net loss per common share is computed by dividing the net loss adjusted on an "as if converted" basis, by the weighted average number of common shares outstanding plus potential dilutive securities. For the year ended July 31, 2009, potential dilutive securities had an anti-dilutive effect and were not included in the calculation of diluted net loss per common share.

Recently issued accounting pronouncements. Effective August 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements ("SFAS 157"), which provides guidance on how to measure assets and liabilities that use fair value. SFAS 157 applies whenever another U.S. GAAP standard requires (or permits) measurement of assets or liabilities at fair value, but does not expand the use of fair value to any new circumstances. The Company also adopted FASB Staff Position ("FSP") No. FAS 157-2, Effective Date of FASB Statement No. 157, which allows the Company to partially defer the adoption of SFAS 157. This FSP defers the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Nonfinancial assets and nonfinancial liabilities include all assets and liabilities other than those meeting the definition of a financial asset or financial liability as defined in paragraph 6 of Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. The adoption of SFAS No. 157 and FSP No. 157-2 had no impact on our financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" which establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and for disclosure to enable evaluation of the nature and financial effects of the business combination. SFAS 141R is effective for ATSI as to business combinations the Company makes beginning in fiscal 2010. The Company adopted this standard as of August 1, 2009 and does not expect it to have an impact on the Company’s financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51. SFAS 160 introduces significant changes in the accounting and reporting for business acquisitions and noncontrolling interest in a subsidiary. SFAS 160 also changes the accounting and reporting for the deconsolidation of a subsidiary. Companies are required to adopt the new standard for fiscal years beginning after January 1, 2009. The Company adopted this standard effectively August 1, 2009 and does not expect it to have an impact on the Company’s financial statements.

In April 2008, the FASB issued Staff Position FSP FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"). The FSP amends the factors considered in developing renewal or extension assumptions for determining the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets." The FSP's intent is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under other accounting principles generally accepted in the U.S. Companies must adopt the FSP for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. Companies must apply the guidance for determining the useful life of a recognized intangible asset prospectively to intangible assets acquired after the effective date. Companies must also apply certain disclosure requirements prospectively to all intangible assets recognized as of, and subsequent to, the effective date. The Company adopted this standard effectively August 1, 2009 and does not expect it to have an impact on the Company’s financial statements.

In May 2008, the FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement), which specifies that issuers of convertible debt instruments that may be settled in cash upon conversion should separately account for the liability and equity components in a manner reflecting their nonconvertible debt borrowing rate when interest costs are recognized in subsequent periods. FSP APB 14-1 is effective for interim periods and fiscal years beginning after December 15, 2008. The Company adopted this standard effectively August 1, 2009 and does not expect it to have an impact on the Company’s financial statements.

In June 2008, the FASB ratified EITF Issue 07-5, “Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock” (“EITF 07-5”). Paragraph 11(a) of Statement of Financial Accounting Standard No 133, “Accounting for Derivatives and Hedging Activities” (“SFAS 133”) specifies that a contract that would otherwise meet the definition of a derivative, but is both (a) indexed to its own stock and (b) classified in stockholders’ equity in the statement of financial position would not be considered a derivative financial instrument. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer’s own stock, including evaluating the instrument’s contingent exercise and settlement provisions, and thus able to qualify for the SFAS 133 paragraph 11(a) scope exception. It also clarifies the impact of foreign-currency-denominated strike prices and market-based employee stock option valuation instruments on the evaluation. EITF 07-5 will be effective for the first annual reporting period beginning after December 15, 2008, and early adoption is prohibited.

In November 2008, the FASB issued EITF Issue 08-8, Accounting for an Instrument (or an Embedded Feature) with a Settlement Amount That Is Based on the Stock of an Entity's Consolidated Subsidiary ("EITF No. 08-8"). This Issue was effective for fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years, with early adoption prohibited. EITF No. 08-8 supersedes EITF No. 00-6 and amends EITF 00-19 such that provided that the subsidiary is a substantive entity, instruments indexed to the stock of a subsidiary could be considered indexed to the entity's own stock within the consolidated financial statements. The Company adopted this standard effectively August 1, 2009 and does not expect it to have an impact on the Company's financial statements.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS 165"), which provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. Since FAS 165 at most requires additional disclosures, the adoption did not have a material impact on ATSI's consolidated financial position, results of operations or cash flows.

ATSI does not expect the adoption of any other recently issued accounting pronouncements to have a significant impact on ATSI's results of operations, financial position or cash flows.

NOTE 2 - ACCOUNTS RECEIVABLE

On December 12, 2007, ATSI entered into a $3,000,000 accounts receivable financing agreement with Wells Fargo Business Credit ("WFBC"), a division of Wells Fargo Bank, N.A. On March 26, 2008, WFBC increased the accounts receivable financing to $5,000,000. ATSI may offer to sell with recourse not less than $350,000 and no more than $5,000,000 of its accounts receivable to WFBC each month. WFBC pays to ATSI 85% of the aggregate amount of each account transferred under the Account Transfer Agreement. Once the account is collected by WFBC, it retains the amount originally paid for the account plus a daily factoring rate of 0.0349% for each day outstanding measured from the funding date and until the account is paid by ATSI's customer. If an account is not paid within 90 days, ATSI must repurchase the account for the amount that it originally received for the account and pay the factor rate that has accrued prior to repurchase. The factoring agreement is for twelve months and ATSI can terminate this agreement upon 30 days written notice, subject to a $15,000 early termination fee. Under the receivable financing agreement with WFBC, ATSI is factoring approximately $32,000 of its monthly receivables. As of July 31, 2009, ATSI did not have any outstanding receivables under the Wells Fargo Factoring agreement. ATSI will continue to factor its receivables on a monthly basis as services are rendered to its customers.

NOTE 3 – INTANGIBLE ASSETS

During fiscal 2008 ATSI loaned $150,000 to NetSapiens Inc. The note receivable had a maturity date of June 26, 2008 with interest at 8% per year. The note was secured by NetSapiens' proprietary Starter Platform License and SNAPsolution modules. On June 26, 2008 ATSI converted the outstanding interest and principal balance into a lifetime and perpetual NetSapiens' License. The License provides ATSI with the ability to offer Hosted PBX (Private Branch eXchange), IP Centrex application, prepaid calling, call center, conferencing, messaging and other innovative telephony functionality necessary to offer standard and/or custom services to the Residential and Enterprise markets. The NetSapiens' License is being amortized equally over a period of 10 years.

NOTE 4 - PROPERTY AND EQUIPMENT

Following is a summary of ATSI's property and equipment at July 31, 2009 and 2008 (in thousands):

	Useful lives	2009	2008
Telecom equipment & software	1-5 years	$ 794	$ 611
Less: accumulated depreciation		(576)	(439)
Net–property and equipment		$ 218	$ 172

For the years ended July 31, 2009 and 2008, depreciation and amortization totaled approximately $152,000 and $160,000, respectively.

NOTE 5 – DEBT

At July 31, 2009 and 2008 outstanding debt consisted of the following: (In thousands, except per share amounts)

	July 31, 2009		July 31, 2008	
9% Convertible Subordinated Debenture, bearing interest at 9.00% per annum maturing June 1, 2010, convertible into common stock annually at the higher of: A) $0.27 per share or B) the average closing price of ATSI common stock for the 10 days immediately preceding the date of conversion, subject to a maximum number of 1,540,741 common shares issuable upon conversion, outstanding balance, net of unamortized discount of $0 and $5, respectively. On October 20, 2008 we reached a settlement agreement with the Debenture holders, as result we converted the outstanding principal balance and accrued interest of $166 into 637,723 shares of common stock.	$	-	$	159
Note payable to CCA Financial Services payable in monthly installments bearing interest at 13.50% per annum, maturing December 31, 2008, collateralized by ATSI's equipment, deposit of accounts and accounts receivables. On October 23, 2008, we paid in full the total outstanding principal balance and accrued interest of $54.		-		101
Note payable to Alfonso Torres, payable upon maturity, bearing interest of 6.00% per annum, maturing January 31, 2011, unsecured.		460		460
Note payable to The Shaar Fund, payable in quarterly installments bearing interest of 7.50% per annum, maturing April 12, 2012. On October 30, 2008, we reached a settlement agreement, in which we agreed to pay $290 to fully satisfy the note. Additionally, the note holder agreed to provide us with a discount of $108, unsecured.		-		416

Note payable to Wells Fargo bank payable in monthly installments, bearing interest at 7.00% per annum, maturing April 1, 2009, collateralized by ATSI's certificates of deposit.		-		39
Note payable to Wells Fargo bank payable in monthly installments, bearing interest at 7.25% per annum, maturing July 25, 2010, collateralized by ATSI's certificates of deposit.		72		138
Note payable to ATVF, Scott Crist, Roderick Ciaccio & Vencore Solutions, payable in monthly installments, bearing interest at 10.00% per annum, maturing September 10, 2010, collateralized by ATSI's accounts receivables (other than accounts factored with Wells Fargo), $100,000 certificate of deposit with Wells Fargo and ATSI's ownership in ATSICOM. Additionally, we issued 425,000 warrants to the note holders, at an exercise price per warrant of $0.19. The warrants have the following “Put” and “Call” rights: Put right. From and after the second anniversary of the notes payable, the holder shall have the right to request from ATSI, upon five (5) Business days prior notice, to acquire from the holders the warrants at a price $0.39 per warrant. Call right. At any time any warrants are outstanding, if the last sale price of ATSI’s common stock is greater than $.80 per share for ten (10) consecutive trading days, ATSI shall be entitled to require the purchaser to exercise the warrants and pay the exercise price therefore upon five (5) business days written notice. Net of unamortized discount of $33 and $0, respectively.		604		-
Note payable to San Antonio National Bank payable in monthly installments, bearing interest at 8.00% per annum, maturing October 25, 2011, collateralized by ATSI's assets.		328		-
Total outstanding debt long-term debt		1,464		1,313
Current portion of long-term debt		(1,173)		(644)
Long-term debt, net of current portion	$	291	$	669

Payments on long-term debt of ATSI are due as follows:

	(in thousands)
Fiscal 2010	$ 1,173
Fiscal 2011	291
Total payments	$ 1,464

ATSI analyzed these instruments for derivative accounting consideration under SFAS 133 and EITF 00-19, and determined that the warrants issued to ATVF, Scott Crist, Roderick Ciaccioa & Vencore Solutions did not meet the definition of equity under SFAS 133 and EITF 00-19, due to the put right. ATSI estimated the fair market value of the put to be the difference between the potential cash settlement price per share and the exercise price, or approximately $85,000 which is the maximum amount of potential cash settlement by ATSI. Because the maximum cash settlement was greater than the fair value of the warrants, ATSI recorded the maximum cash settlement of $85,000 as a liability. Additionally, ATSI analyzed the rest of the instruments for derivative accounting and determined that liability treatment was not applicable.

NOTE 6 – GAIN ON EARLY EXTINGUISHMENT OF DEBT

In December 2007, ATSI entered into a promissory note payable with The Shaar Fund, Ltd. The promissory note was entered into as a result of the settlement agreement reached in which all parties agreed to release each other from all claims relating to the Series D Preferred Stock. As part of the settlement ATSI agreed to pay to The Shaar Fund, Ltd. the sum of $75,000 in cash in December 2007 and issue to The Shaar Fund a promissory note in the original principal amount of $450,000, bearing interest at the rate of 7.5% per annum and payable in 16 quarterly payments over 48 months. If paid in full within the first 18 months, ATSI is entitled to a discount of 22.5% on the then outstanding principal balance. On October 30, 2008, ATSI entered into a note discharged agreement and agreed to pay to The Shaar Fund, Ltd. $290,000 to satisfy the principal and accrued interest outstanding of $390,625 and $7,534, respectively. As a result of the discharge agreement, ATSI recognized a gain on early extinguishment of debt of $108,160.

NOTE 7 - INCOME TAXES

At July 31, 2009, ATSI had a consolidated net operating loss carry-forward (“NOL”) of approximately $17,665,000 expiring ranging from 2020 through 2029. ATSI had no deferred tax asset resulting from its NOL. The loss carry forwards are subject to certain limitations under the Internal Revenue Code including Section 382 of the Tax Reform Act of 1986.

ATSI conducts a periodic examination of its valuation allowance. Factors considered in the evaluation include recent and expected future earnings and ATSI’s liquidity and equity positions. As of July 31, 2009, ATSI has determined that a valuation allowance is necessary for the entire amount of deferred tax assets.

Deferred tax assets are comprised of the following as of July 31, 2009 and 2008:

	2009	2008
Deferred tax assets	$ 6,183,000	$ 5,642,000
Valuation allowance	(6,183,000)	(5,642,000)
Total deferred tax asset, net	$ -	$ -

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109” (FIN 48). This Interpretation provides guidance on recognition, classification and disclosure concerning uncertain tax liabilities. The evaluation of a tax position requires recognition of a tax benefit if it is more likely than not it will be sustained upon examination. We adopted this Interpretation effective January 1, 2007. The adoption did not have a material impact on our consolidated financial statements.

NOTE 8 - COMMITMENTS AND CONTINGENCIES

Leases:

ATSI leases its office space with monthly payments of $4,245; the lease expires in November 2011. The annual rent expense under the operating lease was $49,419 and $50,937 for 2008 and 2009, respectively. The future minimum lease payments under the operating lease are as follows:

FY2010	49,020
FY2011	49,020
FY2012	12,255

NOTE 9 – EQUITY

Common Stock

During the year ended July 31, 2009 ATSI issued:

- 637,723 common shares to the holders of the Convertible Debentures in lieu of the conversion of notes payable in the principal amount of $166,400 and accrued interest of $5,785 at a conversion price of $0.27, in accordance with the original terms of the notes which allowed for voluntary conversion by the company at a conversion price at the higher of (a) $0.27 per share or (b) the average closing price of ATSI's common stock for the 10 days immediately preceding the date of conversion.

- 5,611,963 common shares to its employees and directors for services rendered. ATSI recorded the fair value of $225,000 as the compensation expense in its statement of operations

During the year ended July 31, 2008 ATSI issued:

- 149,288 common shares valued at $30,820 to its placement agent and consultants for their services rendered.

- 1,299,398 common shares to its employees and directors for services rendered. ATSI recorded the fair value of $272,873 as the compensation expense in its statement of operations.

- 3,434 common shares to a Series H Preferred Stock stockholder for an conversion of the Series H Preferred Stock.

- 130,436 common shares to Alfonso Torres in lieu of $30,000 in accrued interest associated with the Alfonso Torres note payable.

- 391,348 common shares to the holders of the Convertible Debentures in lieu of a principal payment of $83,200 and $22,464 in accrued interest.

Preferred Stock

The terms of ATSI's preferred stock restrict ATSI from declaring and paying dividends on ATSI's common stock until such time as all outstanding dividends have been fulfilled related to the preferred stock. The outstanding preferred stock have liquidation preference prior to common stock and ratably with each other.

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Series D Preferred Stock

Series D Preferred Stock was issued in February 2000. The Series D Preferred Stock accrues cumulative dividends at the rate of 6% per annum payable quarterly. The Series D Preferred Stock and any accumulated, unpaid dividends may be converted into Common Stock for up to two years at the lesser of a) the market price on the day prior to closing or b) 83% of the five lowest closing bid prices on the ten days preceding conversion. The terms of ATSI's Series D Preferred Stock allow for mandatory redemption by the holder upon certain conditions. The Series D Preferred Stock allows the holder to elect redemption upon the change of control of ATSI at 120% of the sum of $1,300 per share and accrued and unpaid dividends. Additionally, the holder may elect redemption at $1,270 per share plus accrued and unpaid dividends if ATSI refuses to honor conversion notice or if a third party challenges conversion. The Series D Preferred Stock holders are not entitled to vote.

On December 10, 2007, ATSI and The Shaar Fund entered into a settlement agreement relating to certain litigation. ATSI paid $75,000 on December 12, 2007 and agreed to pay another $450,000 with interest at 7.5% per annum in quarterly payments of $16,667 on each of January 31, 2008 and April 30, 2008, and in quarterly payments of $26,042 commencing on July 31, 2008 and continuing until April 30, 2012. If paid in full within the first 18 months, ATSI will be entitled to a discount of 22.5% on the then outstanding principal balance. On October 30, 2008, ATSI entered into a note discharged agreement and subsequently paid The Shaar Fund, Ltd. $290,000 to satisfy the principal and accrued interest outstanding of $390,625 and $7,534, respectively. As a result of the discharge agreement ATSI recognized a gain on early extinguishment of debt of $108,160.

Series E Preferred Stock

Series E Preferred Stock were issued in October 2000 with a stated value of $1,000 per share.. The Series E Preferred Stock contain certain conversion and redemption features which provide that (1) they may be converted into Common Stock for up to three years at the lesser of a) the market price – defined as the average of the closing bid price for the five lowest of the ten trading days prior to conversion or b) the fixed conversion price – defined as 120% of the lesser of the average closing bid price for the ten days prior to closing or the October 12, 2000 closing bid price and (2) allow for mandatory redemption by the holder upon certain conditions. The Series E Preferred Stock allows the holder to elect redemption at $1,250 per share plus 6% per annum if: 1) ATSI refuses conversion notice, 2) an effective registration statement was not obtained by prior to March 11, 2001, 3) bankruptcy proceedings are initiated against ATSI, 4) The Secretaría de Comunicaciones y Transportes of the SCT limits or terminates the scope of the concession or, 5) if ATSI fails to maintain a listing on NASDAQ, NYSE or AMEX. ATSI believes that the holders of the Series E Preferred Stock can no longer enforce the conversion or redemption features of the Preferred Stock instruments due to, among other things, the expiration of the applicable statute of limitations.

In August 2007, ATSI paid $175,000 to the Series E Preferred Stock stockholders and the 1,170 shares of Series E Preferred Stock were cancelled.

NOTE 10 – STOCK-BASED COMPENSATION TO EMPLOYEES

In September 2005, ATSI adopted its 2005 stock compensation plan. This plan authorizes the grant of up to 7.5 million warrants, stock options, restricted common shares, non-restricted common shares and other awards to employees, directors, and certain other persons. The plan is intended to permit ATSI to retain and attract qualified individuals who will contribute to the overall success of ATSI. ATSI's Board of Directors determines the terms of any grants under the plan. Exercise prices of all warrants, stock options and other awards vary based on the market price of the shares of common stock as of the date of grant. The warrants, stock options, restricted common stock, non-restricted common stock and other awards vest based on the terms of the individual grant.

In August 2007, ATSI's Board of Directors approved an amendment to the plan. Under the amendment, ATSI's Board of Directors increased the maximum aggregate number of shares of Common Stock that may be issued under the Plan from 7.5 million shares to 17.5 million shares.

During the year ended July 31, 2008, ATSI granted:

- Options to purchase 1,835,000 common shares to certain employees and Board Members with an exercise price of $0.21 per share, the closing price of ATSI's common stock on the grant date, August 15, 2007. One third of the options vested immediately on the grant date and the remaining two-thirds will vest as follows: one-third on the first anniversary of the grant date and one-third on the second anniversary of the grant date. All options expire if not exercised on or before the tenth anniversary of the grant date. Under the fair value option method, ATSI recognized $89,000 of compensation expense associated with the vested options on the date of grant. ATSI will recognize the remaining $177,000 of non-cash compensation expense related to un-vested options over the relevant service periods.

- Options to purchase 750,000 common shares to an employee with an exercise price of $0.23 per share, the closing price of ATSI's common stock on the grant date, September 1, 2007. Upon successfully achieving performance objectives set by ATSI's board of directors, the options will vest one-third on the first anniversary of the date of grant, one-third on the second anniversary of the date of grant, and one-third on the third anniversary of the date of grant. All options expire if not exercised on or before the tenth anniversary of the grant date. Under the fair value option method, ATSI will recognize $119,000 of non-cash compensation expense over the relevant service period.

- Options to purchase 30,000 common shares to an employee with an exercise price of $0.27 per share, the closing price of ATSI's common stock on the grant date, November 1, 2007. The options will vest one-third on the first anniversary of the date of grant, one-third on the second anniversary of the date of grant, and one-third on the third anniversary of the date of grant. All options expire if not exercised on or before the tenth anniversary of the grant date. Under the fair value option method, ATSI will recognize $5,500 of non-cash compensation expense over the relevant service period.

- Options to purchase 100,000 common shares to an employee with an exercise price of $0.18 per share, the closing price of ATSI's common stock on the grant date, January 28, 2008. The options will vest one-third on the first anniversary of the date of grant, one-third on the second anniversary of the date of grant, and one-third on the third anniversary of the date of grant. All options expire if not exercised on or before the tenth anniversary of the grant date. Under the fair value option method, ATSI will recognize $14,753 of non-cash compensation expense over the relevant service period.

- ATSI issued 1,299,398 shares of unrestricted common stock to its employees and directors for services rendered with a value of $272,873.

During the year ended July 31, 2009, ATSI granted:

- an option to an employee to purchase 75,000 common shares at an exercise price of $0.16 per share, the closing price of ATSI's common stock on the grant date, September 23, 2008. The options vest equally at each anniversary of the grant date over a three year period. All options expire if not exercised on or before the seventh anniversary of the grant date. Under the fair value option method, ATSI will recognize over the relevant service periods $9,990 of non-cash compensation expense related to un-vested options.

- an option to an employee to purchase 200,000 common shares at an exercise price of $0.13 per share, the closing price of ATSI's common stock on the grant date, October 13, 2008. The options vest equally at each anniversary of the grant date over a three year period. All options expire if not exercised on or before the seventh anniversary of the grant date. Under the fair value option method, ATSI will recognize over the relevant service periods $22,156 of non-cash compensation expense related to un-vested options.

- an option to an employee to purchase 60,000 common shares at an exercise price of $0.13 per share, the closing price of ATSI's common stock on the grant date, November 4, 2008. The options vest equally at each anniversary of the grant date over a three year period. All options expire if not exercised on or before the seventh anniversary of the grant date. Under the fair value option method, ATSI will recognize over the relevant service periods $6,681 of non-cash compensation expense related to un-vested options.

- options to two (2) employees to purchase an aggregate of 520,000 common shares at an exercise price of $0.08 per share, the closing price of ATSI's common stock on the grant date, January 30, 2009, 250,000 vests September 1, 2009, 10,000 vests November 1, 2009, 250,000 vests September 1, 2010 and 10,000 vests November 1, 2010. All options expire if not exercised on or before the seventh anniversary of the grant date. Under the fair value option method, ATSI will recognize over the relevant service periods $35,564 of non-cash compensation expense related to un-vested options.

- On January 30, 2009, ATSI's Board of Directors approved the amendment of previously awarded stock options and as a result ATSI cancelled 8,239,000 stock options and reissued 7,619,000 stock options to various employees. The new exercise price of these options is set at $0.08 per share, the closing price as of the date of the amendment of the terms. The options vested upon issuance and will expire if not exercised on or before the seventh anniversary of the grant date. Under SFAS No.123R, a modification of the terms of an award that makes it more valuable shall be treated as an exchange of the original award for a new award. In substance, the entity repurchases the original instrument by issuing a new instrument of greater value, incurring additional compensation cost for that incremental value. The incremental value shall be measured by the difference between (a) the fair value of the modified option determined in accordance with the provisions of this section and (b) the value of the old option immediately before its terms are modified, determined based on the shorter of (1) its remaining expected life or (2) the expected life of the modified option. Upon issuance, ATSI recognized $46,038 of non-cash incremental compensation expense. These options were subsequently canceled during fiscal 2009.

- On July 16, 2009, ATSI's Board of Directors approved the amendment of previously awarded stock options and as a result ATSI cancelled 7,619,000 stock options and reissued 7,619,000 stock options to various employees. The new exercise price of these options is set at $0.04 per share, the closing price as of the date of the amendment of the terms. The options vested upon issuance and will expire if not exercised on or before the seventh anniversary of the grant date. Under SFAS No.123R, a modification of the terms of an award that makes it more valuable shall be treated as an exchange of the original award for a new award. In substance, the entity repurchases the original instrument by issuing a new instrument of greater value, incurring additional compensation cost for that incremental value. The incremental value shall be measured by the difference between (a) the fair value of the modified option determined in accordance with the provisions of this section and (b) the value of the old option immediately before its terms are modified, determined based on the shorter of (1) its remaining expected life or (2) the expected life of the modified option. Upon issuance, ATSI recognized $9,747 of non-cash incremental compensation expense.

- On July 16, 2009, ATSI's Board of Directors approved the amendment of previously awarded stock options and as a result ATSI reissued 520,000 stock options to two employees at an exercise price of $0.04 per share, the closing price as of the date of the amendment of the terms, 250,000 vest September 1, 2009, 10,000 vest November 1, 2009, 250,000 vest September 1, 2010 and 10,000 vest November 1, 2010. All options expire if not exercised on or before the seventh anniversary of the grant date. Under the fair value option method, ATSI will recognize over the relevant service periods $19,439 of non-cash compensation expense related to un-vested options.

During the year ended July 31, 2009, ATSI forfeited:

- ATSI forfeited 720,000 options to purchase common shares to various employees that were terminated during fiscal 2009. None of the options had vested.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	For the Years Ended July 31,	
	2009	2008

Expected dividends yield	0.00%	0.00%
Expected stock price volatility	126% - 296%	75% - 105%
Risk-free interest rate	2.28% - 3.48%	3.15% - 4.65%
Expected life of options	3.75 - 4.5 years	4 - 6 years

ATSI recognized $388,000 and $695,000 in stock based compensation expense to employees during years ended July 31, 2009 and 2008, respectively. Unamortized compensation cost totaled $27,960 and $147,174 at July 31, 2009 and July 31, 2008, respectively.

ATSI estimates the expected life of its options using the "simplified method" allowed for under SAB 107 which is the average between the contract term and the weighted average vesting period of the options.

The aggregate intrinsic value for the options outstanding as of July 31, 2009 and 2008 is $68,340 and $164,780, respectively.

A summary of the options as of July 31, 2009 and 2008 and the changes during the years ended July 31, 2009 and 2008 are presented below:

2005 Stock Compensation Plan	Options	Weighted-average exercise price	Weighted-average remaining contractual term (years)
Outstanding at July 31, 2007	5,599,000	$ 0.17	6
Granted	2,715,000	0.22	6
Forfeited	(75,000)	0.21	6
Outstanding at July 31, 2008	8,239,000	0.19	6
Granted	16,613,000	0.06	7
Forfeited	(16,578,000)	0.14	4
Outstanding at July 31, 2009	8,274,000	0.04	7
Exercisable at July 31, 2009	7,619,000	$ 0.04	7

NOTE 11 – WARRANTS ISSUED FOR SERVICES

During the year ended July 31, 2008 ATSI granted 375,000 warrants for consulting services. The exercise price of the warrants was set at $.18 per warrant. ATSI recognized a non-cash warrant expense of $45,753 during the year ended July 31, 2008.

During the year ended July 31, 2009, ATSI issued warrants to purchase 425,000 common shares to ATVF, Scott Crist, Roderick Ciaccio & Vencore solutions.

These warrants have the following "Put" and "Call" rights:

Put right. From and after the second anniversary of the warrants, the holder has the right to require ATSI to redeem the warrants upon five (5) Business days prior notice at price of $0.39 per share of common stock.

Call right. At any time any warrants are outstanding ATSI may require the purchaser to exercise the warrants and pay the exercise price therefore upon five (5) business days written notice if the last sale price of ATSI's common stock is greater than $.80 per share for ten (10) consecutive trading days.

The fair value of the warrants was estimated to be $70,760 on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Expected dividend yield	0.00%
Expected stock price volatility	131.4%
Risk-free interest rate	3.37%
Contractual life of warrants	7 years

ATSI analyzed these warrants for derivative accounting consideration under SFAS 133 and EITF 00-19, and determined that the warrants did not meet the definition of equity under SFAS 133 and EITF 00-19, due to the put right. ATSI estimated the fair market value of the put to be the difference between the potential cash settlement price per share and the exercise price, or approximately $85,000 which is the maximum amount of potential cash settlement by ATSI. Because the maximum cash settlement was greater than the fair value of the warrants, ATSI recorded the maximum cash settlement of $85,000 as a liability.

A summary of the warrants as of July 31, 2009 and 2008 and the changes during the years ended July 31, 2009 and 2008 are presented below:

	Warrants	Weighted-average exercise price	Weighted-average remaining contractual term (years)
Outstanding at July 31, 2007	-	$ -	-
Granted	375,000	0.18	4
Exercised	-	-	-
Forfeited	-	-	-
Outstanding at July 31, 2008	375,000	$ 0.18	4
Granted	425,000	0.19	7
Exercised	-	-	-
Forfeited	-	-	-
Outstanding at July 31, 2009	800,000	$ 0.19	7
Exercisable at July 31, 2009	800,000	$ 0.19	5.5

There were no aggregate intrinsic values on the warrants outstanding as of July 31, 2009 and 2008.

NOTE 12 – SHARE REPURCHASE PROGRAM

On March 24, 2008, ATSI's Board of Directors approved a share buyback plan allowing ATSI to purchase up to $1 million of its common stock. During fiscal 2009 and 2008, ATSI repurchased 295,981 shares and 44,002 shares an average purchase price of $0.17 and $0.22, respectively.

NOTE 13 – NON-STANDARDIZED PROFIT SHARING PLAN

We currently provide a Non-Standardized Profit Sharing Plan. The board of directors approved the plan on September 15, 2006. Under the plan our employees qualified to participate in the plan after one year of employment. Contribution under the plan is based on 25% of the annual base salary of each eligible employee up to $46,000 per year. Contributions under the plan are fully vested upon funding. During fiscal 2009 and 2008, we contributed under the plan $174,000 and $194,000, respectively.

NOTE 14 – EARNINGS (LOSS) PER SHARE

In accordance with SFAS No. 128, "Earnings Per Share," basic earnings per share have been computed based upon the weighted average common shares outstanding. Diluted earnings per share give effect to outstanding convertible preferred shares, warrants and stock options, unless their effect is anti-dilutive. Earnings (loss) per common share have been computed as follows:

	Year ended July 31, 2009		Year ended July 31, 2008	
	(In thousands, except share information)			
Net income (loss) to be used to compute income (loss) per share:				
Net income (loss)	$	(1,508)	$	112
Less preferred dividends		-		328
Net income attributable to common Shareholders		(1,508)		440
Weighted average number of shares:				
Weighted average common shares outstanding - basic		40,043,303		39,143,748
Effect of warrants and options		-		53,571
Weighted average common shares outstanding assuming dilution		40,043,303		39,197,319
Basic income per common share	$	(0.04)	$	0.01
Diluted income per common share	$	(0.04)	$	0.01

NOTE 15 – FINANCIAL CONSOLIDATION OF FIESTA COMMUNICATIONS

On May 1, 2008, ATSI sold all of the outstanding shares of Telefamilia Communications, Inc. to Fiesta Communications, Inc. for 975,000 shares of common stock in Fiesta Communications and $30,000 in cash to be paid through a promissory note in July 2008. With the 975,000 shares obtained from Fiesta, ATSI owns approximately 19.5% of Fiesta. Additionally, on May 1, 2008, Fiesta entered into convertible promissory note with ATSI for $52,984, with a maturity date of May 1, 2011 and an interest rate of 9%. Under the convertible promissory note, Fiesta agreed to pay twelve (12) equal quarterly payments of $5,088 starting on August 1, 2008 and continuing each quarterly period thereafter until all accrued and unpaid interest has been paid.

For the year ended July 31, 2009, ATSI analyzed its investment in Fiesta and concluded that Fiesta to be a Variable Interest Entity as defined under FIN46R. ATSI also evaluated all of its outstanding arrangements with Fiesta and determined ATSI not as a primary beneficiary of Fiesta. ATSI accounted for its investment in Fiesta under equity method. ATSI recognized a loss of $16,000 from its investment in Fiesta during fiscal 2008.

On October 31, 2008, ATSI and Fiesta agreed to extend the maturity date on the $30,000 promissory note to April 30, 2009 and all other terms remained the same. On October 31, 2008, Fiesta entered into a note payable with ATSI for $95,000, with a maturity date of April 30, 2009 and an interest rate of 10%. Additionally, on October 31, 2008, Fiesta paid in full to ATSI a promissory note with a principal balance of $35,000 and $1,467 in accrued interest. During the year ended July 31, 2009, ATSI also advanced additional $80,000 to Fiesta; the promissory note has a maturity date of January 31, 2010 and an interest rate of 8%. This note is secured by Fiesta’s assets, including contracts and intangible assets.

As July 31, 2009, ATSI reconsidered its investment in Fiesta under the guidance of FIN46R and concluded that because the additional funding provided to Fiesta during fiscal 2009, ATSI became the primary beneficiary of Fiesta. ATSI will absorb a majority of losses of Fiesta. As of July 31, 2009, ATSI financially consolidated Fiesta. All significant intercompany transactions and balances have been eliminated.

NOTE 16 – MAJOR CUSTOMERS AND MAJOR VENDORS

ATSI generated 20 percent of its revenues from three customers during the year ended July 31, 2009 and 26 percent of its revenues from three customers during the year ended July 31, 2008.

ATSI incurred 28 percent of its cost of revenues to three vendors during the year ended July 31, 2009 and 43 percent of its cost of revenues to three vendors during the year ended July 31, 2008.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None

ITEM 9A(T). CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

In accordance with Exchange Act Rules 13a-15 and 15a-15, we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of July 31, 2009.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on our evaluation under the framework in Internal Control—Integrated Framework issued by COSO, our management concluded that our internal control over financial reporting was effective as of July 31, 2009 in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities Exchange Commission that permit the company to provide only management's report in this annual report.

ITEM 9B. OTHER INFORMATION.

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CORPORATE GOVERNANCE.

Business Experience

The following table contains the name, age of our directors and executive officers.

Name	Age	Position Held
Arthur L. Smith	44	President, Chief Executive Officer and Director
Ruben R. Caraveo	41	Sr. Vice President, Operations and Technology
Antonio Estrada Jr.	34	Sr. Vice President, Treasurer & Corporate Controller
John R. Fleming	55	Director, Interim Executive Chairman of the Board
Murray R. Nye	55	Director

Arthur L. Smith has served as our Chief Executive Officer and Director since May 2003. Mr. Smith also served as the President of ATSI de Mexico S.A de C.V. from August 2002 to April 2003, as our Chief Executive Officer and a Director from June 1996 to July 2002 and as our President since our formation in June 1996 to July 1998. Mr. Smith also served as President, Chief Operating Officer and a director of ATSI-Canada since its formation in May 1994. From December 1993 until May 1994, Mr. Smith served in the same positions with Latcomm International Inc., which amalgamated with Willingdon Resources Ltd. to form ATSI-Canada in May 1994. Mr. Smith also served as Chairman of the Board of ATSI's subsidiary, Globalscape, Inc. (NYSE:GSB), until its spin-off and subsequent sale in June 2002. From June 1989 to December 1993, Mr. Smith was employed as director of international sales by GeoComm Partners, a satellite-based telecommunications company located in San Antonio, providing telecommunications services to Latin America. Mr. Smith has over 20 years' experience in the telecommunications industry.

Ruben R. Caraveo has served as our Sr. Vice President of Operations and Technology since August 2006, and is also the President for our wholly-owned subsidiary Digerati Networks, Inc. Prior to joining ATSI, Mr. Caraveo served as Vice President of Vycera Communications where he was responsible for overseeing wholesale carrier sales, and daily operations, including Engineering, Marketing, and the Network Operations Center. His prior experience also includes management positions with Worldtel Interactive, Frontier, and WorldCom. Mr. Caraveo has more than 20 years' telecommunications industry experience, specializing in the areas of Carrier Sales, Network Operations, Engineering, Data and Systems Analysis, Product Marketing, and Systems Development. Mr. Caraveo attended California State University, Northridge, School of Engineering.

Antonio Estrada Jr. has served as our Sr. Vice President of Finance since August 2007. From May 2003 to July 2007, Mr. Estrada served as the Corporate Controller. From January 2002 through January 2003, Mr. Estrada served as our Director of International Accounting and Treasurer. From January 2001 to January 2002, Mr. Estrada served in various roles, including International Accounting Manager and General Accountant. Prior to joining ATSI in 1999 he served as a Senior Accountant for the Epilepsy Association of San Antonio and South Texas. Mr. Estrada has more than 11 years' experience in the telecommunications industry, financial reporting, treasury management, internal audit, SOX compliance, and accounting. Mr. Estrada graduated from the University of Texas at San Antonio, with a Bachelors of Business Administration, with a concentration in Accounting.

John R. Fleming has served as our Non-executive Chairman of the Board since August 2002 and as one of our Directors since January 2001. Mr. Fleming is the principal and founder of Vision Corporation, an early-stage investment company that focuses on communications technologies, service and hardware. Mr. Fleming also sets on the board of Mediaxstream Communications which is a high definition delivery system that services major studios and sports venues throughout the country. Prior to forming Vision Corporation, Mr. Fleming served as President, International of IXC Communications, Inc. from April 1998 to December 1999. Immediately prior to that he served as IXC's President of Emerging Markets from December 1997, as Executive Vice President of IXC from March 1996 through November 1997 and as Senior Vice President of IXC from October 1994 through March 1996. He served as Vice President of Sales and Marketing of IXC from its formation in July 1992 until October 1994. Prior to that, Mr. Fleming served as Director of Business Development and Director of Carrier Sales of CTI from 1986 to March 1990 and as Vice President of Marketing and Sales of CTI from March 1990 to July 1992. Mr. Fleming was a Branch Manager for Satellite Business Systems from 1983 to 1986 (a unit of IBM).

Murray R. Nye has served as one of our Directors since its formation in June 1996. Mr. Nye also served as of the Chief Executive Officer and a director of ATSI-Canada from its formation in May 1994. From December 1993 until May 1994, Mr. Nye served in the same positions with Latcomm International Inc., which company amalgamated with Willingdon Resources Ltd. to form ATSI-Canada in May 1994. From 1992 to 1995, Mr. Nye served as President of Kirriemuir Oil & Gas Ltd. From 1989 until 1992, Mr. Nye was self-employed as a consultant and Mr. Nye is again currently self-employed as a consultant. Mr. Nye serves as a director of D.M.I. Technologies, Inc., an Alberta Stock Exchange-traded company.

There are no family relationships between or among our directors and executive officers.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors and executive officers and persons who own more than 10% of a registered class of our equity securities to file various reports with the Securities and Exchange Commission concerning their holdings of, and transactions in, securities we issued. Each such person is required to provide us with copies of the reports filed. Based on a review of the copies of such forms furnished to us and other information, we believe that, during the fiscal year ended July 31, 2009, none of our officers, directors or owners of 10% of any class of our securities failed to report transactions in our securities or reported transactions in our securities late.

Code of Ethics

We adopted an Executive Code of Ethics that applies to the Chief Executive Officer, Chief Financial Officer, Controller and other members of our management team. The Executive Code of Ethics may be viewed on our Website, www.atsi.net. A copy of the Executive Code of Ethics will be provided without charge upon written request to ATSI Communications, Inc., 3201 Cherry Ridge, Building C, Suite 300, San Antonio, Texas 78230.

Nominating Committee and Nomination of Directors

We do not have a formal nominating committee because the size of our board of directors is too small to establish separate standing committees. Our directors perform the function of a nominating committee.

The directors consider director candidates recommended by other members of the board of directors, by executive officers and by one or more substantial, long-term stockholders. In addition, the board of directors may seek candidates through a third person recruiter. Generally, stockholders who individually or as a group have held 5% of our shares for over one year will be considered substantial, long-term stockholders. In considering candidates, the directors take into consideration the needs of the board of directors and the qualifications of the candidate. The board of directors has not established a set of criteria or minimum qualifications for candidacy and each candidate is considered based on the demonstrated competence and knowledge of the individual. To have a candidate considered by the directors, a stockholder must submit the recommendation in writing and must include the following information:

- The name of the stockholder and evidence of ownership of our shares, including the number of shares owned and the length of time of ownership; and

- The name of the candidate, the candidate's resume or a listing of her or his qualifications to be one of our directors and the person's consent to be named as a director if nominated by the directors.

The stockholder's recommendation and information described above must be sent to us at 3201 Cherry Ridge, Building C, Suite 300, San Antonio, TX 78230 and, if the nominee is to be elected at a meeting of the stockholders, must be received by the Chief Executive Officer at least 180 days prior to the anniversary date of our most recent annual meeting of stockholders.

Audit Committee and Audit Committee Financial Expert

We do not have an audit or other board committee performing equivalent functions. Our board of directors performs all functions of the audit committee. We do not have an audit committee financial expert because none of our current directors have the necessary training or experience to qualify as a financial expert.

ITEM 11. EXECUTIVE COMPENSATION.

Compensation Discussion and Analysis

Our compensation programs are designed to meet the following objectives:

- Offer compensation opportunities that attract highly qualified executives, reward outstanding initiative and achievement, and retain the leadership and skills necessary to build long-term stockholder value;

- Emphasize pay-for-performance by maintaining a portion of executives' total compensation at risk, tied to both our annual and long-term financial performance and the creation of stockholder value; and

- Further our short and long-term strategic goals and values by aligning executive officer compensation with business objectives and individual performance.

Our board of directors believes that an executive's compensation should be tied to the performance of the individual and the performance of the complete executive team against both financial and non-financial goals, some of which are subjective and within the discretion of the board of directors.

Our executive compensation program is intended to be simple and clear, and consists of the following elements (depending on individual performance):

- Base salary;
- Annual performance-based cash bonus;
- Long-term incentives in the form of stock options; and
- Benefits that are offered to executives on the same basis as our non-executive employees.

Role of Management in Determining Compensation Decisions

At the request of our board of directors, our management makes recommendations to our board of directors relating to executive compensation program design, specific compensation amounts, bonus targets, incentive plan structure and other executive compensation related matters for each of our executive officers, including our Chief Executive Officer. Our board of directors maintains decision-making authority with respect to these executive compensation matters.

Our board of directors reviews the recommendations of our management with respect to total executive compensation and each element of compensation when making pay decisions. In allocating compensation among compensation elements, we emphasize incentive, not fixed compensation to ensure that executives only receive superior pay for superior results. We equally value short- and long-term compensation because both short- and long-term results are critical to our success. In addition, our compensation program includes various benefits provided to all employees, including life insurance, health insurance and other customary benefits. The objectives and details of why each element of compensation is paid are described below.

Base Salary. Our objective for paying base salaries to executives is to reward them for performing the core responsibilities of their positions and to provide a level of security with respect to a portion of their compensation. We consider a number of factors when setting base salaries for executives, including:

- Existing salary levels;
- Competitive pay practices;
- Individual and corporate performance; and
- Internal equity among our executives, taking into consideration their relative contributions to our success.

Annual Incentive Awards. Our objective for offering annual cash bonus awards to our named executive officers is to motivate them to achieve our annual financial goals, while taking into account their individual goals and responsibilities. Our board of directors implemented our 2009 executive officer bonus plan, effective as of the first quarter of fiscal 2009 pursuant to which our named executive officers became eligible to receive cash bonus awards calculated and paid on a quarterly basis. The amounts payable under our 2009 executive officer bonus plan were to be calculated based on our revenue, margin, cash balance and net income for 2009 against the 2009 financial plan approved by our board of directors.

Under our 2009 executive officer bonus plan, we assigned a specific bonus target to each executive for performance in 2009. Our board of directors designed these bonus targets to allow for additional compensation in the event we meet our targets set fort under the financial plan approved by our board of directors. Cash bonus targets were determined based on individual responsibility levels and performance expectations and would be payable in a proportionate amount representing the percentage of our targeted corporate net income goal pursuant to our 2009 financial plan. After discussion and deliberation, our board of directors ultimately approved our management's recommendations as detailed below:

Name	Title	Bonus	
Arthur L. Smith	President, Chief Executive Officer and Director	$	82,500
Ruben R. Caraveo	Sr. Vice President, Operations and Technology	$	74,250
Antonio Estrada Jr.	Sr. Vice President & Corporate Controller	$	60,500

Payouts under our 2009 executive officer bonus plan are dependent on our achievement towards our revenue; margin, cash balance and net income goal such that 100% of the bonus target amounts would be paid upon achievement of 100% of the net income goal. Above and below target performance methodologies were also established

We consider the specific performance goals established in the 2008 and 2009 financial plan to be our confidential information, the disclosure of which would cause us to experience financial harm. We believe that tying annual bonus payments for each of our named executive officers to the achievement of challenging revenue, margin, cash balance and net income goals best aligns the interest of our executives with the interests of our stockholders and promotes a unity of purpose among our key business leaders. Regardless of our actual financial performance under our 2008 and 2009 financial plan, our board of directors retained the discretion to adjust bonuses payable under our 2008 and 2009 executive officer bonus plan up or down as it deemed appropriate.

Long-term Incentive Awards. We award long-term incentive compensation to focus our executives on our long-term growth and stockholder return, as well as to encourage our executives to remain with us for the long-term. Long-term incentive awards are primarily in the form of grants of stock options and/or stock award pursuant to our 2005 Stock Compensation Plan (the "Plan"). We selected this form because of the favorable accounting and tax treatment and the expectation of key employees in our industry that they would receive stock options and/or stock grants. We do not have pre-established target award amounts for long-term incentive grants. In determining long-term incentive awards for the named executive officers, our board of directors relies on recommendations from our Chief Executive Officer, who considers the individual performance of the executives, the relation of the award to base salary and annual incentive compensation, and associated accounting expense The terms of and amount of awards are made by our board of directors in accordance with the Plan.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary ($)	Bonus (1) ($)	Stock Awards (2) ($)	Option Awards (2) ($)	All Other Compensation (3) ($)	Total ($)
Arthur L. Smith	2009	$ 165,000	$ 76,767	$ -0-	$ 2,168	$ 35,429	$ 279,364
CEO & President	2008	$ 150,000	$ 90,392	$ 7,012	$ 94,500	$ 50,738	$ 392,642
Ruben R. Caraveo	2009	$ 148,500	$ 66,185	$ -0-	$ 1,887	$ 39,165	$ 255,737
Senior Vice President of Operations and Technology	2008	$ 135,000	$ 127,371	$ -0-	$ 78,750	$ 47,327	$ 388,448
Antonio Estrada Jr.	2008	$ 121,000	$ 74,590	$ -0-	$ 1,851	$ 46,000	$ 243,441
Senior Vice President of Finance & Corporate Controller	2008	$ 110,000	$ 101,126	$ 15,226	$ 78,750	$ 32,102	$ 337,204

(1) Bonus amounts are based on the bonus payments for the 4th quarter of 2008, a one-time bonus for achieving profitability and positive working capital during fiscal 2008 and one-time bonus for services provided in previous fiscal years without compensation.

(2) A description of the assumptions made in valuation of options granted can be found in Note 10 to the Financial Statements, which is deemed to be a part of this Item.

(3) All other compensation consists of contributions to the Non-Standardized Profit Sharing Plan.

Equity-based Compensation Plans

Our board of directors adopted the 2005 Stock Compensation Plan (the "Plan"). Under the Plan the board of directors may grant up to 17,500,000 shares of our common stock to our officers, directors, employees and consultants. Grants may be in the form of incentive stock options, non-statutory stock options, restricted stock awards, and/or unrestricted stock awards. The number and terms of each award is determined by the board of directors, subject to the limitation that the exercise price of any option may not be less than the fair market value of the common stock on the date of grant. The board of directors has not retroactively granted options, but has repriced options under the Plan. The following tables set forth information about the number of grants made during fiscal 2009 and 2008 and the number of outstanding stock options held by each of our named executive officers as of July 31, 2009.

GRANTS OF PLAN-BASED AWARDS

Name	Grant Date	Number of Shares of Stock or Units (#)	Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards
Arthur L. Smith	8/14/2007	275,000	450,000	$ 0.21	$ 369,500

	7/16/2009	885,737(1)	1,695,000(2)	$	0.04	$	103,230
Ruben R. Caraveo	8/14/2007	225,369	375,000	$	0.21	$	304,119
	7/16/2009	979,130(1)	1,475,000(2)	$	0.04	$	98,165
Antonio Estrada, Jr.	8/14/2007	225,369	375,000	$	0.21	$	304,119
	7/16/2009	1,150,000(1)	1,447,000(2)	$	0.04	$	103,880

(1) Contributions to the Non-Standardized Profit Sharing Plan during fiscal 2009

(2) This represents the repricing of previously issued stock options. A description of the assumptions made in valuation of options granted can be found in Note 10 to the Financial Statements, which is deemed to be a part of this Item.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

	Option Awards				Stock Awards	
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)
Arthur L. Smith	420,000	-	$ 0.04	9/29/2015	-	-
	525,000	-	$ 0.04	10/3/2015	-	-
	300,000	-	$ 0.04	9/25/2016	-	-
	300,000	150,000	$ 0.04	8/15/2017	-	-
Ruben R. Caraveo	375,000	-	$ 0.04	9/29/2015	-	-
	475,000	-	$ 0.04	10/3/2015	-	-
	250,000	-	$ 0.04	9/25/2016	-	-
	250,000	125,000	$ 0.04	8/15/2017	-	-
Antonio Estrada Jr.	347,000	-	$ 0.04	9/29/2015	-	-
	475,000	-	$ 0.04	10/3/2015	-	-
	250,000	-	$ 0.04	9/25/2016	-	-
	250,000	125,000	$ 0.04	8/15/2017	-	-

Non-Standardized Profit Sharing Plan

We currently provide a Non-Standardized Profit Sharing Plan. The board of directors approved the plan on September 15, 2006. Under the plan our employees qualified to participate in the plan after one year of employment. Contribution under the plan by us is based on 25% of the annual base salary of each eligible employee up to $46,000 per year. Contributions under the plan are fully vested upon funding. The following table contains certain information relating to the benefits accrued under the Non-Standardized Profit Sharing Plan for the named executive officers.

NONQUALIFIED DEFERRED COMPENSATION

Name	Executive Contribution in Last FY ($)	Registrant Contribution in Last FY ($)(1)	Aggregate Earnings in Last FY ($)	Aggregate Withdrawals /Distributions ($)	Aggregate Balance at Last FYE ($)(2)
Arthur L. Smith		$ 35,429			$ 50,738
Ruben R. Caraveo		$ 39,165			$ 47,327
Antonio Estrada, Jr.		$ 46,000			$ 32,102

(1) All amounts reported in this column are included as Other Compensation for fiscal 2009 in the Summary Compensation Table.
(2) All amounts reported in this column are included as Other Compensation for fiscal 2008 in the Summary Compensation Table.

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Compensation of Directors

The following table sets forth information relating to compensation of directors who are not also named executive officers during the year ended July 31, 2009.

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
John R. Fleming		$ 25,000(1)	$ 43,000(1)			$ 68,000
Murray R. Nye		$ 25,000(2)	$ 43,000(2)			$ 68,000

(1) As of July 31, 2009, Mr. Fleming had options to purchase an aggregate of 1,075,000 shares of common stock and 625,000 shares of common stock issued pursuant to Stock awards. A description of the assumptions made in valuation of options granted can be found in Note 10 to the Financial Statements, which is deemed to be a part of this Item.

(2) As of July 31, 2009, Mr. Nye had options to purchase an aggregate of 1,075,000 shares of common stock and 625,000 shares of common stock issued pursuant to Stock awards. A description of the assumptions made in valuation of options granted can be found in Note 10 to the Financial Statements, which is deemed to be a part of this Item.

Each Director that is not an officer of the Company receives $2,000 for each meeting of the Board attended in person and $500 for each meeting attended by telephone. In addition to the foregoing, each Director is reimbursed the reasonable out-of-pocket expenses in connection with their travel to an attendance at meetings of the board of directors.

Compensation Committee Interlocks and Insider Participation

Mr. Arthur L. Smith is presently our Chief Executive Officer and serves on our board of directors. In addition, we entered into a transaction with Fiesta Communications, Inc., in which Mr. Smith owns 16% of the outstanding equity interests, in which we transferred all of the issued and outstanding shares of Telefamilia Communications, Inc. to Fiesta Communications, Inc. for a $30,000 secured promissory note and 975,000 shares of common stock of Fiesta. The transaction is discussed in more detail under Item 13 below. Except for Mr. Smith, none of our directors are or have been an officer or employee or had any relationship with that required disclosure in this report.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Information regarding securities authorized to be issued under equity compensation plans is set forth under Item 5 of this Annual Report on Form 10-K.

The following table lists the beneficial ownership of shares of our Common Stock (i) each person know to the Company to own more than 5% of the outstanding voting securities issued by the Company, (ii) each director and nominee, (iii) the named executive officers, and (iv) all directors and officers as a group. Information with respect to officers, directors and their families as of July 31, 2009 and is based on the books and records of the Company and information obtained from each individual. Information with respect to other stockholders is based upon the Schedule 13D or Schedule 13G filed by such stockholders with the Securities and Exchange Commission. Unless otherwise stated, the business address of each individual or group is the same as the address of the Company's principal executive office and all securities are beneficially owned solely by the person indicated.

NAME OF INDIVIDUAL OR GROUP	COMMON STOCK	% OF CLASS (1)	TOTAL VOTING INTEREST
INDIVIDUAL OFFICERS, DIRECTORS AND NOMINEES			
Arthur L. Smith President, Chief Executive Officer Director	3,725,889(2)	7.1%	3,725,889(2)
Ruben R. Caraveo Sr. Vice President, Sales and Operations	2,984,279(3)	5.7%	2,984,279(3)
Antonio Estrada Sr. VP of Finance & Corporate Controller	3,169,828(4)	6.1%	3,169,828(4)
John R. Fleming Director	2,350,090(5)	4.5%	2,350,090(5)
Murray R. Nye Director	2,350,090(6)	4.5%	2,350,090(6)
ALL OFFICERS AND DIRECTORS AS A GROUP	14,580,176(7)	27.9%	14,580,176(7)

(1) Based upon 52,271,120 shares of common stock outstanding as of July 31, 2009. Any shares represented by options exercisable within 60 days after July 31, 2009 are treated as being outstanding for the purpose of computing the percentage of the class for such person but not otherwise.

(2) Includes 1,695,000 shares subject to options exercisable at July 31, 2009.

(3) Includes 1,475,000 shares subject to options exercisable at July 31, 2009.

(4) Includes 1,447,000 shares subject to options exercisable at July 31, 2009.

(5) Includes 1,075,000 shares subject to options exercisable at July 31, 2009.

(6) Includes 1,075,000 shares subject to options exercisable at July 31, 2009.

(7) Includes 6,767,000 shares subject to options exercisable at July 31, 2009.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

On May 1, 2008, ATSI sold all of the outstanding shares of Telefamilia Communications, Inc. to Fiesta Communications, Inc. for 975,000 shares of common stock in Fiesta Communications and $30,000 in cash to be paid through a promissory note in July 2008. With the 975,000 shares obtained from Fiesta, ATSI owns approximately 19.5% of Fiesta. Additionally, on May 1, 2008, Fiesta entered into convertible promissory note with ATSI for $52,984, with a maturity date of May 1, 2011 and an interest rate of 9%. Under the convertible promissory note, Fiesta agreed to pay twelve (12) equal quarterly payments of $5,088 starting on August 1, 2008 and continuing each quarterly period thereafter until all accrued and unpaid interest has been paid.

For the year ended July 31, 2009, ATSI analyzed its investment in Fiesta and concluded that Fiesta to be a Variable Interest Entity as defined under FIN46R. ATSI also evaluated all of its outstanding arrangements with Fiesta and determined ATSI not as a primary beneficiary of Fiesta. ATSI accounted for its investment in Fiesta under equity method. ATSI recognized a loss of $16,000 from its investment in Fiesta during fiscal 2008.

On October 31, 2008, ATSI and Fiesta agreed to extend the maturity date on the $30,000 promissory note to April 30, 2009 and all other terms remained the same. On October 31, 2008, Fiesta entered into a note payable with ATSI for $95,000, with a maturity date of April 30, 2009 and an interest rate of 10%. Additionally, on October 31, 2008, Fiesta paid in full to ATSI a promissory note with a principal balance of $35,000 and $1,467 in accrued interest. During the year ended July 31, 2009, ATSI also advanced additional $80,000 to Fiesta; the promissory note has a maturity date of January 31, 2010 and an interest rate of 8%. This note is secured by Fiesta's assets, including contracts and intangible assets.

As July 31, 2009, ATSI reconsidered its investment in Fiesta under the guidance of FIN46R and concluded that because the additional funding provided to Fiesta during fiscal 2009, ATSI became the primary beneficiary of Fiesta. ATSI will absorb a majority of losses of Fiesta. As of July 31, 2009, ATSI financially consolidated Fiesta. All significant intercompany transactions and balances have been eliminated.

ATSI's CEO and President, Arthur L Smith, is a 16% stockholder of Fiesta.

Except as set forth above, we have not engaged in any transactions in which a member of the board of directors had an interest. Our board of directors has determined that the directors other than Mr. Smith are independent as that term is defined in New York Stock Exchange Rule 303A.02.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The following table sets forth the aggregate fees paid to Malone & Bailey, PC for audit services rendered in connection with the audits and reviews of ATSI's consolidated financial statements and reports for the years ended July 31, 2009 and 2008.

	Year Ended July 31,	
Description of Fees	2009	2008
Audit Fees	$ 74,000	$ 68,000
Tax fees	-0-	-0-

The board of directors has instructed Malone and Bailey, PC that any fees for non-audit services must be approved before being incurred. We did not incur any non-audit fees to Malone and Bailey, PC during fiscal 2009.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

The following documents are exhibits to this report.

2.1 Plan and Agreement of Merger of ATSI Communications, Inc. with and into ATSI Merger Corporation, dated as of March 24, 2004. (Exhibit 2.1 to Form 8-K of ATSI filed on May 24, 2004)

3.1 Articles of Incorporation of ATSI Merger Corporation. (Exhibit 3.1 to Form 8-K of ATSI filed on May 24, 2004)

3.2 Bylaws of ATSI Merger Corporation. (Exhibit 3.2 to Form 8-K of ATSI filed on May 24, 2004)

3.3 Articles of Merger of ATSI Communications, Inc. with and into ATSI Merger Corporation. (Exhibit 3.3 to Form 8-K of ATSI filed on May 24, 2004)

4.1 Secured Promissory Note and Security Agreement dated November 4, 2005 between ATSI Communications, Inc. and CSI Business Finance, Inc.(Exhibit 4.2 to form 10-QSB for the period Ended October 31, 2005 filed December 15, 2005)

4.2 Convertible Debenture Agreement(Exhibit 4.18 to Annual Report on Form 10-KSB for the year ended July 31, 2006 filed October 30, 2006)

4.3 Promissory note payable to Alfonso Torres dated October 1, 2007 in the principal amount of $459,170. (Exhibit 10.4 to Form 10-QSB for the period ended October 31, 2006 filed December 1 4, 2007)

4.4 Promissory note payable to The Shaar Fund dated December 10, 2007 in the principal amount of $460,000. (Exhibit 10.2 to Form 10-QSB for the period ended October 31, 2006 filed December 1 4, 2007)

4.5 Promissory Notes payable to several holders dated September 26, 2008 in the principal amount of $850,000. (Exhibit 4.6 to Form 10-KSB for the period ended July 31, 2009 filed October 29, 2008)

4.6 Promissory note payable to San Antonio National Bank dated October 23, 2008 in the principal amount of $425,000. (Exhibit 10.1 to Form 10-KSB for the period ended October 31, 2008 filed December 15, 2008)

4.7 Promissory note receivable between ATSI Communications, Inc. and Fiesta Communications, Inc. dated October 31, 2008 for $95,000.(Exhibit 10.2 to Form 10-KSB for the period ended October 31, 2008 filed December 15, 2008)

4.8 Note Discharge Agreement dated October 30, 2008 between ATSI Communications, Inc. and The Shaar Fund, Inc. (Exhibit 10.3 to Form 10-KSB for the period ended October 31, 2008 filedDecember 15, 2008)

4.9 Settlement Agreement dated October 20, 2008 between ATSI Communications, Inc. and the 9% Convertible Debenture holders. (Exhibit 10.4 to Form 10-KSB for the period ended October 31, 2008 filed December 15, 2008)

10.1 Interconnection Agreement TELMEX and ATSICOM (English summary) (Exhibit 10.26 to Annual Report on Form 10-K for year ended July 31, 2003 filed November 12, 2003)

10.2 Interconnection Agreement TELMEX and ATSICOM (English Translation) (Exhibit 10.27 to Amended Annual Report on Form 10-K/A for the year ended July 31, 2003 filed March 2, 2004)

10.3 Settlement Agreement dated December 10, 2007 between ATSI Communications, Inc. and The Shaar Fund, Inc. (Exhibit 10.3 to Form 10-QSB for the period ended October 31, 2006 filed December 1 4, 2007)

10.4 Confidential Settlement Agreement dated August 27, 2007 between ATSI Communications, Inc. and RGC International Investors, LDC. (Exhibit 10.7 to Annual Report on Form 10-KSB for the period ended July 31, 2007 filed October 17, 2007)

21.1 Subsidiary List *

31.1 Certification of our President and Chief Executive Officer, under Section 302 of the Sarbanes-Oxley Act of 2002. *

31.2 Certification of our Corporate Controller and Principal Financial Officer, under Section 302 of the Sarbanes-Oxley Act of 2002. *

32.1 Certification of our President and Chief Executive Officer, under Section 906 of the Sarbanes-Oxley Act of 2002. *

32.2 Certification of our Corporate Controller and Principal Financial Officer, under Section 906 of the Sarbanes-Oxley Act of 2002. *

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ATSI COMMUNICATIONS, INC.

Date: October 15, 2009

By: /s/ Arthur L. Smith
Arthur L. Smith
President and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacity and on the dates indicated.

Signature	Title	Date
/s/ Arthur L. Smith Arthur L. Smith	Principal Executive Officer and Director	October 15, 2009
/s/ Antonio Estrada Jr. Antonio Estrada Jr.	Principal Accounting Officer Principal Finance Officer	October 15, 2009
/s/ John R. Fleming John R. Fleming	Director	October 15, 2009
/s/ Murray R. Nye Murray R. Nye	Director	October 15, 2009

EXHIBIT INDEX

Number	Description
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