

ATSI COMMUNICATIONS INC/DE  
Form 10-Q  
December 14, 2010

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended October 31, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-15687

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

Nevada  
(State or Other Jurisdiction of  
Incorporation or Organization)

74-2849995  
(I.R.S. Employer  
Identification No.)

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

78230  
(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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

Edgar Filing: ATSI COMMUNICATIONS INC/DE - Form 10-Q

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filler," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.:

Large accelerated filer   
Non-accelerated filer

Accelerated filer   
Smaller reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

| Number of Shares | Class Common Stock | As of             |
|------------------|--------------------|-------------------|
| 52,962,850       | \$001. par value   | December 13, 2010 |

---

ATSI COMMUNICATIONS, INC.  
QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTER ENDED OCTOBER 31, 2010

INDEX

|  | Page  |
|--|---|
| <b>PART I. FINANCIAL INFORMATION</b>   |   |
| <b>Item 1.</b>   | <b>Financial Statements</b>   |
| Consolidated Balance Sheets as of October 31, 2010 and July 31, 2010 (unaudited)                                   | 3   |
| Consolidated Statements of Operations for the Three Months Ended October 31, 2010 and 2009 (unaudited)             | 4   |
| Consolidated Statement of Changes in Stockholders' Deficit for the Three Months Ended October 31, 2010 (unaudited) | 5   |
| Consolidated Statements of Cash Flows for the Three Months Ended October 31, 2010 and 2009 (unaudited)             | 6   |
| Notes to Consolidated Financial Statements (unaudited)   | 7   |
| <b>Item 2.</b>   | <b>Management's Discussions and Analysis of Financial Condition and Results of Operations</b> |
|  | 9   |
| <b>Item 3.</b>   | <b>Quantitative and Qualitative Disclosures about Market Risk</b>                             |
|  | 12  |
| <b>Item 4.</b>   | <b>Controls and Procedures</b>  |
|  | 12  |
| <b>PART II. OTHER INFORMATION</b>  |   |
| <b>Item 6.</b>   | <b>Exhibits</b>   |
|  | 12  |

## PART 1. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

|   | October 31,<br>2010 | July 31,<br>2010 |
|---|---------------------|------------------|
| <b>ASSETS</b>   |                     |                  |
| <b>CURRENT ASSETS:</b>  |                     |                  |
| Cash and cash equivalents   | \$ 261              | \$ 73            |
| Accounts receivable, net of allowance for bad debt of \$10 and \$10, respectively   | 645                 | 526              |
| Prepaid and other current assets  | 37                  | 48               |
| Total current assets  | 943                 | 647              |
| <b>LONG-TERM ASSETS:</b>  |                     |                  |
| Deferred financing fees   | 64                  | -                |
| Intangible assets, net of accumulated amortization of \$35 and \$16, respectively   | 115                 | 119              |
| Property and equipment  | 859                 | 856              |
| Less - accumulated depreciation   | (748)               | (727)            |
| Net property and equipment  | 111                 | 129              |
| Total assets  | \$ 1,233            | \$ 895           |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>  |                     |                  |
| <b>CURRENT LIABILITIES:</b>   |                     |                  |
| Accounts payable  | \$ 550              | \$ 637           |
| Accrued liabilities   | 82                  | 106              |
| Notes payable, net of unamortized discount of \$0 and \$1, respectively   | 376                 | 409              |
| Derivative liability  | 10                  | 85               |
| Total current liabilities   | 1,018               | 1,237            |
| <b>LONG-TERM LIABILITIES:</b>   |                     |                  |
| Notes payable   | 1,157               | 639              |
| Customer deposits   | 115                 | 16               |
| Total long-term liabilities   | 1,272               | 655              |
| Total liabilities   | 2,290               | 1,892            |
| <b>STOCKHOLDERS' DEFICIT:</b>   |                     |                  |
| Preferred stock, 16,063,000 shares authorized, none issued and outstanding  | -                   | -                |
| Common stock, \$0.001 par value, 150,000,000 shares authorized, 52,962,850 and 45,504,120 shares issued and outstanding, respectively | 53                  | 46               |
| Additional paid in capital  | 73,527              | 73,276           |
| Accumulated deficit   | (74,500)            | (74,182)         |

Edgar Filing: ATSI COMMUNICATIONS INC/DE - Form 10-Q

|   |          |        |
|---|----------|--------|
| Other comprehensive income                            | 1        | 1      |
| Total ATSI Communications, Inc. stockholders' deficit | (919)    | (859)  |
| Noncontrolling interest                               | (138)    | (138)  |
| Total stockholders' deficit                           | (1,057)  | (997)  |
| Total liabilities and stockholders' deficit           | \$ 1,233 | \$ 895 |

Unaudited, see accompanying notes to financial statements

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

|  | Three months ended October 31, |                   |
|--|--------------------------------|-------------------|
|  | 2010                           | 2009              |
| <b>OPERATING REVENUES:</b>   |                                |                   |
| VoIP services  | \$ 4,252                       | \$ 4,985          |
| <b>Total operating revenues</b>  | <b>4,252</b>                   | <b>4,985</b>      |
| <b>OPERATING EXPENSES:</b>   |                                |                   |
| Cost of services (exclusive of depreciation and amortization)                          | 3,865                          | 4,705             |
| Selling, general and administrative expense (exclusive of legal and professional fees) | 577                            | 368               |
| Legal and professional fees  | 56                             | 98                |
| Depreciation and amortization expense  | 25                             | 44                |
| <b>Total operating expenses</b>  | <b>4,523</b>                   | <b>5,215</b>      |
| <b>OPERATING LOSS</b>  | <b>(271)</b>                   | <b>(230)</b>      |
| <b>OTHER INCOME (EXPENSE):</b>   |                                |                   |
| Interest expense   | (47)                           | (43)              |
| <b>Total other expense</b>   | <b>(47)</b>                    | <b>(43)</b>       |
| <b>NET LOSS</b>  | <b>(318)</b>                   | <b>(273)</b>      |
| <b>NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTEREST</b>                                | <b>-</b>                       | <b>24</b>         |
| <b>NET LOSS ATTRIBUTABLE TO ATSI COMMUNICATIONS, INC.</b>                              | <b>\$ (318)</b>                | <b>\$ (249)</b>   |
| <b>LOSS PER SHARE - BASIC AND DILUTED</b>  | <b>\$ (0.01)</b>               | <b>\$ (0.01)</b>  |
| <b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING - BASIC AND DILUTED</b>                  | <b>45,990,559</b>              | <b>45,504,120</b> |

Unaudited, see accompanying notes to financial statements

ATSI COMMUNICATIONS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' DEFICIT  
FOR THE QUARTER ENDED OCTOBER 31, 2010  
(In thousands, except share amounts)

|                              | Common<br>Shares | Par   | Additional<br>Paid-in<br>Capital | Noncontrolling<br>interest | Accumulated<br>Deficit | Other<br>Comp.<br>Income/Loss | Totals     |
|------------------------------|------------------|-------|----------------------------------|----------------------------|------------------------|-------------------------------|------------|
| BALANCE, July<br>31, 2010    | 45,504,120       | \$ 46 | \$ 73,276                        | \$ (138)                   | \$ (74,182)            | 1                             | \$ (997)   |
| Stock option<br>expense      | 7,458,730        | 7     | 251                              | -                          | -                      | -                             | 258        |
| Net loss                     | -                | -     | -                                | -                          | (318)                  | -                             | (318)      |
| BALANCE,<br>October 31, 2010 | 52,962,850       | \$ 53 | \$ 73,527                        | \$ (138)                   | \$ (74,500)            | 1                             | \$ (1,057) |

Unaudited, see accompanying notes to financial statements

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

|   | Three months ended October<br>31, |               |
|---|-----------------------------------|---------------|
|   | 2010                              | 2009          |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                            |                                   |               |
| Net loss  | \$ (318)                          | \$ (273)      |
| Adjustments to reconcile net loss to cash used in operating activities: |                                   |               |
| Depreciation and amortization   | 25                                | 44            |
| Amortization of deferred financing fees                                 | 9                                 | -             |
| Issuance of stock grants and options for services                       | 258                               | 14            |
| Amortization of debt discount   | 1                                 | 12            |
| Changes in operating assets and liabilities:                            |                                   |               |
| Accounts receivable   | (119)                             | (280)         |
| Prepaid expenses and other  | 12                                | (7)           |
| Accounts payable  | (88)                              | 115           |
| Accrued liabilities   | (18)                              | (33)          |
| Customer deposits   | 100                               | -             |
| Net cash used in operating activities                                   | (138)                             | (408)         |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                            |                                   |               |
| Investment in certificates of deposit                                   | -                                 | 264           |
| Purchases of property & equipment                                       | (3)                               | (15)          |
| Net cash (used in) provided by investing activities                     | (3)                               | 249           |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                            |                                   |               |
| Payment of deferred financing fees                                      | (73)                              | -             |
| Payments on notes payable   | (200)                             | (172)         |
| Proceeds from notes payables  | 677                               | -             |
| Acquisition of put option on warrants                                   | (75)                              | -             |
| Principal payments on capital lease obligation                          | -                                 | (1)           |
| Net cash provided by (used in) financing activities                     | 329                               | (173)         |
| <b>DECREASE IN CASH AND CASH EQUIVALENTS</b>                            | <b>188</b>                        | <b>(332)</b>  |
| CASH AND CASH EQUIVALENTS, beginning of period                          | 73                                | 637           |
| <b>CASH AND CASH EQUIVALENTS, end of period</b>                         | <b>\$ 261</b>                     | <b>\$ 305</b> |
| <b>SUPPLEMENTAL DISCLOSURES:</b>  |                                   |               |
| Cash paid for interest  | \$ 30                             | \$ 25         |
| Cash paid for income tax  | -                                 | -             |

Unaudited, see accompanying notes to financial statements





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

## NOTE 1 – BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements of ATSI Communications, Inc. have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the United States Securities and Exchange Commission. In the opinion of management, these interim financial statements contain all adjustments, consisting of normal recurring adjustments necessary for a fair presentation of financial position and the results of operations for the interim periods presented. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to the consolidated financial statements, which would substantially duplicate the disclosure contained in the audited financial statements for the most recent fiscal year ended July 31, 2010, as reported in Form 10-K filed on October 8, 2010, have been omitted.

## NOTE 2 – OUTSTANDING DEBT

Outstanding debt consisted of the following: (In thousands)

|   | October 31,<br>2010 | July 31,<br>2010 |
|---|---------------------|------------------|
| Note payable to Alfonso Torres, payable upon maturity, bearing interest of 6.00% per annum, maturing July 31, 2012, unsecured.  | \$ 545              | \$ 537           |
| 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 ATSI.COM. 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 \$0 and \$1, respectively | -                   | 133              |
| 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.   | 153                 | 189              |
| Note payable to ATV Texas Ventures payable in monthly installments, bearing interest at 12.00% per annum, maturing November 10, 2011, collateralized by ATSI's assets.  | 57                  | 69               |
| Note payable to ATV Texas Ventures payable in monthly installments, bearing interest at 12.00% per annum, maturing January 10, 2012, collateralized by ATSI's assets.   | 65                  | 77               |

Edgar Filing: ATSI COMMUNICATIONS INC/DE - Form 10-Q

|  |          |        |
|--|----------|--------|
| Note payable to ATV Texas Ventures payable in monthly installments, bearing interest at 12.00% per annum, maturing March 10, 2012, collateralized by ATSI's assets.  | 37       | 43     |
| Note payable to ATV Texas Ventures payable in monthly installments, bearing interest at 12.00% per annum, maturing October 10, 2012, collateralized by ATSI's assets.  | 200      | -      |
| Note payable to Thermo Credit, LLC., interest payment for the first twenty-three months with a balloon payment on the twenty-fourth month, maturing August 2, 2012, collateralized by ATSI's accounts receivable. Bearing an annual interest rate equivalent to the lesser of the maximum rate and the greater of the prime rate plus 8.25% and 11.5%, a commitment fee of 2% and weekly monitoring fee of .05%. ATSI is required to maintain the following financial covenants: 1) A consolidated debt service coverage ratio, for the 12-month period, of not less than 1.0 as of the last day of each quarter and 2) A consolidated operating income, for the 12-month period, of not less than zero as of the last day of each fiscal year | 476      | -      |
| Total outstanding long-term debt   | 1,533    | 1,048  |
| Current portion of long-term debt  | (376)    | (409)  |
| Long-term debt, net of current portion   | \$ 1,157 | \$ 639 |

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

|                |                |       |
|----------------|----------------|-------|
|                | (in thousands) |       |
| Fiscal 2011    | \$             | 376   |
| Fiscal 2012    |                | 1,157 |
| Total payments | \$             | 1,533 |

ATSI analyzed these instruments for derivative accounting consideration and determined that the warrants issued to ATVF, Scott Crist, Roderick Ciaccio & Vencore Solutions qualify as derivative instruments, 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.

On October 12, 2010, three of the warrant holders exercised their put rights and as a result, the Company made payments to the related warrant holders amounting to \$75,000 which was charged to derivative liability. The Company cancelled the related warrants as a result of the payment made for the put rights.

#### NOTE 3 – STOCK-BASED COMPENSATION

In September 2005, ATSI adopted its 2005 stock compensation plan. This plan, as amended, authorizes the grant of up to 17.5 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.

During the quarter ended October 31, 2010:

- ATSI granted 1,333,333 common shares to its directors for services rendered. The Company recognized stock-based compensation expense of \$40,000 equivalent to the value of the shares calculated based on the share's closing price at the grant date.
- ATSI granted 6,125,396 common shares to various employees as part of the Company's profit sharing plan contribution. The Company recognized stock-based compensation expense of \$183,762 equivalent to the value of the shares calculated based on the share's closing price at the grant date.
- ATSI extended the term of existing options totaling 7,359,000 to July 31, 2015. As a result, the Company recognized incremental compensation expense of \$34,501.
- 375,000 warrants were cancelled as a result of the warrant holders exercising their related put rights (see Note 2).

ATSI recognized \$258,000 and \$14,000 in stock based compensation expense to employees during the quarter ended October 31, 2010 and 2009, respectively. Unamortized compensation cost totaled \$1,621 and \$14,028 at October 31, 2010 and October 31, 2009, respectively.

As of October 31, 2010, ATSI had outstanding options totaling 7,494,000 with a weighted average exercise price of \$0.04, a weighted average remaining term of 5 years and an intrinsic value of zero.

As of October 31, 2010, ATSI had outstanding warrants totaling 425,000 with a weighted average exercise price of \$0.18, a weighted average remaining term of 4.50 years and an intrinsic value of zero.

#### NOTE 4 – 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 qualify to participate in the plan after one year of employment. Contributions under the plan are 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 the quarters ended October 31, 2010 and 2009, we contributed \$183,762 and \$0, respectively.

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

**SPECIAL NOTE:** This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities 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," "plan," and "intend." Although we believe these expectations are reasonable, our operations involve a number of risks and uncertainties. Some of these risks include the availability and capacity of competitive data transmission networks and our ability to raise sufficient capital to continue operations. Additional risks are included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on October 8, 2010.

The following is a discussion of the consolidated financial condition and results of operations of ATSI for the three months ended October 31, 2010 and 2009. It should be read in conjunction with our Consolidated Financial Statements, the Notes thereto, and the other financial information included in the Company's Annual Report on Form 10-K for the year ended July 31, 2010. For purposes of the following discussion, fiscal 2011 or 2011 refers to the year ended July 31, 2011 and fiscal 2010 or 2010 refers to the year ended July 31, 2010.

### General

We are an international telecommunications carrier that utilizes the internet to provide cost-efficient and economical international telecommunications services. Our current operations consist 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.

We also provide enhanced hosted VoIP Services, which include fully hosted IP/PBX services, IP trunking, call center applications, prepaid services, and customized VoIP solutions for specialized applications. Under our current network, we provide interactive voice response auto attendant, call recording, simultaneous calling, voicemail to email conversion, and multiple other IP/PBX features in a hosted environment. As an outsourced VoIP technology enabler, we are marketing new and synergistic services to other carriers and to enterprise customers through established channel partners.

### Results of Operations

The following table sets forth certain items included in our results of operations and variances between periods for the three months ended October 31, 2010 and 2009. All dollar amounts are in thousands.

|  | Three months ended October 31, |            |            |            |
|--|--------------------------------|------------|------------|------------|
|  | 2010                           | 2009       | Variations | %          |
| <b>OPERATING REVENUES:</b>   |                                |            |            |            |
| VoIP services  | \$ 4,252                       | \$ 4,985   | \$ (733)   | -15%       |
| Total operating revenues   | 4,252                          | 4,985      | (733)      | -15%       |
| Cost of services (exclusive of depreciation and amortization, shown below) | 3,865                          | 4,705      | (840)      | -18%       |
| <b>GROSS MARGIN</b>  | <b>387</b>                     | <b>280</b> | <b>107</b> | <b>38%</b> |

|  |          |          |         |       |
|--|----------|----------|---------|-------|
| Selling, general and administrative expense (exclusive of legal and professional fees) | 577      | 368      | 209     | 57%   |
| Legal and professional fees  | 56       | 98       | (42)    | -43%  |
| Depreciation and amortization expense  | 25       | 44       | (19)    | -43%  |
| OPERATING LOSS   | (271)    | (230)    | (41)    | 18%   |
| OTHER INCOME (EXPENSE):  |          |          |         |       |
| Interest expense   | (47)     | (43)     | (4)     | 9%    |
| Total other expense, net   | (47)     | (43)     | (4)     | 9%    |
| NET LOSS   | \$ (318) | \$ (273) | \$ (45) | 16%   |
| NET LOSS ATTRIBUTABLE TO NONCONTROLLING INTEREST                                       | -        | 24       | (24)    | -100% |
| NET LOSS ATTRIBUTABLE TO ATSI COMMUNICATIONS, INC.                                     | \$ (318) | \$ (249) | \$ (69) | 28%   |

Three Months ended October 31, 2010 Compared to Three Months ended October 31, 2009

VoIP Service. VoIP services revenue decreased by \$733,000, or 15%, from the quarter ended October 31, 2009 to the quarter ended October 31, 2010. VoIP minutes carried by our network decreased by 9% from approximately 133,538,511 minutes of voice traffic during the quarter ended October 31, 2009 to approximately 120,992,987 minutes of voice traffic during the quarter ended October 31, 2010. Our average revenue per minute decreased from \$0.037 during the quarter ended October 31, 2009 to \$0.035 for the quarter ended October 31, 2010. The decrease in revenue and the average revenue per minute is attributable primarily to the price pressure in our market due to a reduction of international termination.

Cost of Services (exclusive of depreciation and amortization). The consolidated cost of services decreased by \$840,000, or 18%, from the quarter ended October 31, 2009 to the quarter ended October 31, 2010. The decrease in cost of services is a direct correlation to the decrease in VoIP services revenue. Cost of services, as a percentage of revenue decreased by 3.48 % between periods, from 94.38% of revenue during the quarter ended October 31, 2009 to 90.90% of revenue during the quarter ended October 31, 2010. The decrease in cost of services as a percentage of revenue was due to the decrease in costs from our vendors realized during the quarter ended October 31, 2010. Also, as a result of the decrease in VoIP revenues and decrease in costs of service as a percent of sales, our gross margin improved by \$107,000, or 38%, from \$280,000 for the three months ended October 31, 2009 compared to \$387,000 for the three months ended October 31, 2010.

Selling, General and Administrative (SG&A) Expenses (exclusive of legal and professional fees). SG&A expenses increased by \$209,000, or 57%, from the quarter ended October 31, 2009 to the quarter ended October 31, 2010. The increase in SG&A is primarily attributed to the increase in non-cash compensation expense to employees between periods. During the quarter ended October 31, 2010, we recognized \$258,000 in non-cash compensation expense to employees, but during the quarter ended October 31, 2009 we only recognized \$14,000 in non-cash compensation expense to employees.

Legal and professional fees. Legal and professional fees decreased by \$42,000, or 43%, from the quarter ended October 31, 2009 to the quarter ended October 31, 2010. The decrease is attributable to the decrease in investor relations fees, audit fees and attorney's fees as a result of expense control measures implemented during fiscal 2011.

Depreciation and amortization. Depreciation and amortization decreased by \$19,000 or 43%, from the quarter ended October 31, 2009 to the quarter ended October 31, 2010. The decrease is attributed to the decline in amortization on assets that had reached their useful life; as a result the assets were no longer required to be depreciated during the three months ended October 31, 2010.

Operating loss. The Company reported an operating loss \$271,000 for the three months ended October 31, 2010 compared to an operating loss of \$230,000 for the three months end October 31, 2009. The increase in operating loss is primarily attributed to the recognition of \$258,000 in non-cash compensation expense to employees during the quarter ended October 31, 2010; we only recognized \$14,000 of non-cash compensation expense to employees during the quarter ended October 31, 2009.



Other income (expense). Other expenses increased by \$4,000, or 9% from the quarter ended October 31, 2009 to the quarter ended October 31, 2010. The primary reason for the increase in other expenses is attributed to the increase in interest expense as a result of the increase in outstanding financings secured during the quarter ended October 31, 2010.

Net Loss. Net loss increased by \$45,000 or 16%, from the quarter ended October 31, 2009 to the quarter ended October 31, 2010. The increase in net loss is primarily attributed to the recognition of \$258,000 in non-cash compensation expense to employees during the quarter ended October 31, 2010: we only recognized \$14,000 of non-cash compensation expense to employees during the quarter ended October 31, 2009.

Net Loss Attributable to Noncontrolling Interest. Loss attributed to noncontrolling interest improved by \$24,000, or 100%, from the quarter ended October 31, 2009 to the quarter ended October 31, 2010. During the quarter October 31, 2009, we recognized \$24,000 associated to the losses incurred in Fiesta and Telefamilia, however, during the quarter ended October 31, 2010 we did not incur any losses related to Fiesta and Telefamilia, since the related investment has been written off.

Net Loss Attributable to ATSI Communications, Inc. The Company reported a net loss of \$318,000 for the quarter ended October 31, 2010 compared to a net loss to common stockholders of \$249,000 for the quarter ended October 31, 2009. The increase in net loss to common stockholders between periods is attributed to the recognition of \$258,000 in non-cash compensation expense to employees during the quarter ended October 31, 2010; we only recognized \$14,000 of non-cash compensation expense to employees during the quarter ended October 31, 2009. The increase in non-cash compensation expense to employees was slightly offset between periods by the increase in margin of \$107,000 and the decrease in legal and professional fees of \$36,000.

#### Liquidity and Capital Resources

Cash Position: We had a cash balance of \$261,000 as of October 31, 2010. Net cash consumed by operating activities during the quarter ended October 31, 2010 was approximately \$138,000. Investing activities during the quarter ended October 31, 2010 consumed \$3,000, consisting of the acquisition of various servers and computers. Financing activities during the quarter ended October 31, 2010 provided \$329,000 in cash. We received proceeds of \$677,000 from various promissory notes during the quarter ended October 31, 2010. The cash consumed during the period is associated with the debt principal payments of \$200,000 related to various notes payable, the acquisition of a put option on certain warrants for \$75,000 and the payment of financing fees on the Thermo Credit note of \$73,000. Overall, our net operating, investing and financing activities during the quarter ended October 31, 2010 contributed \$188,000 of our available cash.

We are currently utilizing our available cash to fund any deficiencies in our cash flows from operations. During the quarter ended October 31, 2010 we received \$200,000 from Texas Ventures under the 24 month promissory note. On August 2, 2010, we entered into a \$750,000 revolving credit facility with Thermo Credit to finance our expected growth during the year ending July 31, 2011.

Our current cash expenses are expected to be approximately \$165,000 per month, including wages, rent, utilities, corporate professional fees and debt service. We are currently using \$128,000 in cash generated from operations of our available cash to cover all monthly cash outflows. We anticipate that the cash balance of \$261,000, the \$750,000 revolving credit facility with Thermo Credit, combined with our ability to raise additional cash from our funding sources and expected net cash flow generated from future operations, will be sufficient to fund our operations and capital asset expenditures for the next twelve months.

Our working capital (deficit) was \$75,000 as of October 31, 2010. This represents an improvement of \$515,000 from our working capital (deficit) at July 31, 2010 of \$590,000.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

NONE

### ITEM 4. 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 October 31, 2010.

#### Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended October 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 6. EXHIBITS

The following documents are filed as exhibits to this report.

| Number | Description   |
|--------|---|
| 10.1   | Promissory note payable and security agreement with ATV Texas Ventures III, LP., dated October 10, 2010 in the principal amount of \$200,000. |
| 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 with the requirements 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.  
(Registrant)

Date: December 13, 2010

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

Date: December 13, 2010

By: /s/ Antonio Estrada Jr.  
Name: Antonio Estrada Jr.  
Title: Sr. VP of Finance & Corporate Controller  
(Principal Accounting and Principal Financial  
Officer)

EXHIBIT INDEX

| Number | Description   |
|--------|---|
| 10.1   | Promissory note payable and security agreement with ATV Texas Ventures III, LP., dated October 10, 2010 in the principal amount of \$200,000. |
| 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.               |