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DIAL THRU INTERNATIONAL CORP
Form 10-Q
September 15, 2003

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended July 31, 2003

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from _____ to _____

Commission File Number 0-22636

DIAL THRU INTERNATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

75-2461665

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

17383 Sunset Boulevard, Suite 350
Los Angeles, California

90272

(Address of principal executive offices)

(Zip Code)

(310) 566-1700

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 periods 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 is an accelerated filer (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 practicable date. As of September 12, 2003, 16,201,803 shares of common stock, \$.001 par value per share, were outstanding.

PART I. FINANCIAL INFORMATION

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ITEM 1. Financial Statements

DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

| ASSETS ----- | July 31, 2003 ----- (unaudited) | October 31, 2002 ----- |
|--|--|------------------------------|
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 1,054,940 | \$ 488,868 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$362,017 at July 31, 2003 and \$548,467 at October 31, 2002 | 1,204,057 | 1,369,955 |
| Prepaid expenses and other current assets | 227,861 | 147,209 |
| | ----- | ----- |
| Total current assets | 2,486,858 | 2,006,032 |
| | ----- | ----- |
| PROPERTY AND EQUIPMENT, net | 1,696,193 | 3,203,663 |
| ADVERTISING CREDITS, net | 2,376,678 | 2,376,678 |
| INTANGIBLE ASSETS, net | - | 330,613 |
| GOODWILL, net | 1,796,917 | 1,796,917 |
| OTHER ASSETS | 160,795 | 73,525 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 8,517,441 | \$ 9,787,428 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' DEFICIT ----- | | |
| CURRENT LIABILITIES | | |
| Current portion of capital leases | 302,511 | 389,450 |
| Trade accounts payable | 5,563,426 | 5,405,356 |
| Accrued liabilities | 3,097,925 | 2,313,873 |
| Deferred revenue | 368,431 | 331,786 |
| Deposits and other payables | 438,570 | 444,204 |
| Note payable, net of debt discount of \$7,118 at July 31, 2003 | 542,882 | - |
| Notes payable to related parties, net of debt discount of \$105,823 at July 31, 2003 and \$423,291 at October 31, 2002 | 2,242,578 | 1,925,110 |
| | ----- | ----- |
| Total current liabilities | 12,556,323 | 10,809,779 |
| | ----- | ----- |
| CAPITAL LEASES, net of current portion | 5,796 | 72,365 |
| NOTE PAYABLE, net of debt discount of \$28,548 at July 31, 2003 | 1,221,452 | - |
| CONVERTIBLE DEBENTURE, net of debt discount of \$12,906 at July 31, 2003 and \$163,510 at October 31, 2002 | 487,094 | 880,365 |
| | ----- | ----- |
| SHAREHOLDERS' DEFICIT | | |
| Preferred stock, \$.001 par value; 10,000,000 shares authorized; none issued and outstanding | - | - |
| Common stock, \$.001 par value; 44,169,100 shares authorized; 16,172,968 shares issued at July 31, 2003 and 15,074,916 shares issued at October 31, 2002 | 16,173 | 15,075 |

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| | | |
|--|--------------|--------------|
| Additional paid-in capital | 39,072,166 | 38,894,064 |
| Accumulated deficit | (44,352,635) | (40,631,392) |
| Accumulated other comprehensive income | (432,157) | (196,057) |
| Treasury stock, 12,022 common shares at cost | (54,870) | (54,870) |
| Subscription receivable - common stock | (1,901) | (1,901) |
| | ----- | ----- |
| Total shareholders' deficit | (5,753,224) | (1,975,081) |
| | ----- | ----- |
| TOTAL LIABILITIES AND SHAREHOLDERS' DEFICIT | \$ 8,517,441 | \$ 9,787,428 |
| | ===== | ===== |

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

DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

| | Three Months Ended July 31, | | Nine Months Ended July 31, | |
|---|--------------------------------|----------------|-------------------------------|----------------|
| | 2003 | 2002 | 2003 | 2002 |
| | ----- | ----- | ----- | ----- |
| REVENUES | \$ 5,474,269 | \$ 6,138,790 | \$17,142,101 | \$18,811,698 |
| COSTS AND EXPENSES | | | | |
| Cost of revenues | 4,049,387 | 4,127,502 | 12,723,169 | 12,754,660 |
| Sales and marketing | 215,296 | 374,681 | 801,598 | 1,079,663 |
| General and administrative | 1,233,831 | 1,767,549 | 4,060,208 | 5,740,654 |
| Depreciation and amortization | 429,865 | 596,065 | 1,397,229 | 1,889,148 |
| Write down of impaired assets | 683,678 | - | 683,678 | - |
| Sales tax settlement | - | - | 350,000 | - |
| | ----- | ----- | ----- | ----- |
| Total costs and expenses | 6,612,057 | 6,865,797 | 20,015,882 | 21,464,125 |
| | ----- | ----- | ----- | ----- |
| Operating loss | (1,137,788) | (727,007) | (2,873,781) | (2,652,427) |
| OTHER INCOME (EXPENSE) | | | | |
| Interest expense and financing costs | (204,718) | (350,559) | (852,126) | (932,377) |
| Foreign exchange | (4,831) | (5,049) | 4,664 | (32,071) |
| Gain on sales of equipment | - | - | - | 8,553 |
| | ----- | ----- | ----- | ----- |
| Total other income (expense) | (209,549) | (355,608) | (847,462) | (955,895) |
| | ----- | ----- | ----- | ----- |
| NET LOSS | \$ (1,347,337) | \$ (1,082,615) | \$ (3,721,243) | \$ (3,608,322) |
| | ===== | ===== | ===== | ===== |
| LOSS PER SHARE: | | | | |
| Basic and diluted loss per share | \$ (0.08) | \$ (0.07) | \$ (0.23) | \$ (0.27) |
| | ===== | ===== | ===== | ===== |
| SHARES USED IN THE CALCULATION OF PER SHARE AMOUNTS: | | | | |
| Basic and diluted common shares | 16,138,033 | 14,436,350 | 15,940,612 | 13,558,049 |
| | ===== | ===== | ===== | ===== |

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

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DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

| | Nine Months Ended July 31, | |
|---|-------------------------------|----------------|
| | 2003 | 2002 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | \$ (3,721,243) | \$ (3,608,322) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Gain from disposal of fixed assets | - | (8,553) |
| Stock and warrants issued for services | - | 13,750 |
| Bad debt expense | 30,378 | 550,120 |
| Non-cash interest expense | 543,212 | 684,413 |
| Depreciation and amortization | 1,397,229 | 1,889,148 |
| Effects of changes in foreign exchange rates | (340,215) | (99,621) |
| Write down of impaired assets | 683,678 | - |
| (Increase) decrease in: | | |
| Trade accounts receivable | 135,520 | (101,800) |
| Prepaid expenses and other current assets | (80,652) | (129,565) |
| Other assets | (45,632) | 24,916 |
| Increase (decrease) in: | | |
| Trade accounts payable | 158,603 | (1,011,715) |
| Accrued liabilities | 792,374 | 600,821 |
| Deferred revenue | 36,645 | (24,928) |
| Deposits and other payables | (5,634) | 1,422 |
| Net cash used in operating activities | (415,737) | (1,219,914) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of property and equipment | (138,709) | (263,769) |
| Refund of license fee | - | 1,424,899 |
| Net cash provided by (used in) investing activities | (138,709) | 1,161,130 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from notes payable | 1,800,000 | - |
| Proceeds from related party note payable | - | 300,000 |
| Proceeds from convertible debentures | - | 550,000 |
| Payments on capital leases | (154,041) | (141,395) |
| Deferred financing fees | (82,441) | (92,625) |
| Subscription receivable-common stock | - | 15,179 |
| Payments on convertible debentures | (443,000) | - |
| Net cash provided by financing activities | 1,120,518 | 631,159 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 566,072 | 572,375 |
| Cash and cash equivalents at beginning of period | 488,868 | 94,985 |
| Cash and cash equivalents at end of period | \$ 1,054,940 | \$ 667,360 |
| SUPPLEMENTAL SCHEDULE OF NON CASH INVESTING AND FINANCING ACTIVITIES | | |

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| | | |
|---|------------|-----------|
| Conversion of convertible debenture and accrued interest to common stock | \$ 109,197 | \$ - |
| Fair value of warrants issued with debt | 70,002 | 176,858 |
| Conversion of convertible note to common stock | - | 500,000 |
| Exercise of stock options in exchange for retirement of 100,000 common shares | - | 70,000 |
| Acquisition of customer base for payable | - | (340,931) |

The accompanying notes are an integral part of these consolidated financial statement

DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - OPERATIONS AND BASIS OF PRESENTATION

The consolidated financial statements of Dial Thru International Corporation and its subsidiaries, "DTI" or "the Company", included in this Form 10-Q are unaudited and do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the financial position and operating results for the three and nine month periods ended July 31, 2003 have been included. Operating results for the three and nine month periods ended July 31, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending October 31, 2003. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the fiscal year ended October 31, 2002.

The Company is a full service, facility-based provider of communication products to small and medium size businesses, both domestically and internationally. The Company provides a variety of international and domestic communication services including international dial thru, Internet voice and fax services, e-commerce solutions and other value-added communication services, using its Voice over Internet Protocol ("VoIP") Network to effectively deliver these services to the end user.

In addition to helping customers achieve significant savings on long-distance voice and fax calls by routing calls over the Internet or the Company's private network, the Company also offers new opportunities for existing Internet Service Providers who want to expand into voice services, private corporate networks seeking to lower long-distance costs, and Web-enabled corporate call centers engaged in electronic commerce.

The Company has also introduced VoIP to a new segment of customers by delivering a high quality, reliable and scalable solution that uniquely addresses the needs of the rapidly growing VoIP industry.

Estimates and Assumptions

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

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NOTE 2 - GOING CONCERN

The Company has an accumulated deficit of approximately \$44.4 million as well as a working capital deficit of approximately \$10.1 million as of July 31, 2003. Funding of the Company's working capital deficit, current and future operating losses, and expansion will require continuing capital investment. The Company expects to fund these cash requirements through operations, debt facilities and additional equity financing.

The Company obtained additional debt financing of \$1,250,000 in November 2002, a portion of which was used to repay the balance of the Company's April 11, 2001 convertible debenture with Global Capital Funding Group L.P., and \$550,000 in July 2003.

Although the Company has been able to arrange debt facilities and equity financing to date, there can be no assurance that sufficient debt or equity financing will continue to be available in the future or that it will be available on terms acceptable to the Company. Failure to obtain sufficient capital could materially affect the Company's operations and expansion strategies. As a result of the aforementioned factors and related uncertainties, there is doubt about the Company's ability to continue as a going concern.

NOTE 3 - CONCENTRATION OF CREDIT RISK AND SIGNIFICANT CUSTOMERS

The Company provided wholesale services to a single customer who accounted for 12% of the overall revenue of the Company for the three months ended July 31, 2003.

NOTE 4 - STOCK-BASED COMPENSATION

In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), the Company accounts for its stock-based employee compensation plans using the intrinsic valued method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations. As such, compensation expense is recorded on the date of grant to the extent the current market price of the underlying stock exceeds the option exercise price. The Company did not record any stock-based compensation expense in the three and nine months ended July 31, 2003 and 2002.

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS 148"), which amends SFAS 123. SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require more prominent and more frequent disclosures in financial statements of the effects of stock-based compensation. The Company anticipates that it will continue to apply APB 25. Accordingly, the Company believes that the adoption of this standard will have no material impact on its financial position, results of operations or cash flows.

Had the Company determined compensation based on the fair value at the grant date for its stock options in accordance with SFAS 123, as amended by SFAS 148, net loss and loss per share would have been increased as follows:

| Three Months Ended July 31, | Nine Months Ended July 31, |
|--------------------------------|-------------------------------|
| ----- | ----- |

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| | 2003 ----- | 2002 ----- | 2003 ----- | 2002 ----- |
|--|-------------------------|-------------------------|-------------------------|-------------------------|
| Net loss, as reported | \$ (1,347,337) | \$ (1,082,615) | \$ (3,721,243) | \$ (3,608,322) |
| Deduct: Stock based employee compensation expense determined under fair value based method | (45,364) | (85,925) | (153,424) | (257,775) |
| Pro forma net loss | \$ (1,392,701) ===== | \$ (1,168,540) ===== | \$ (3,874,667) ===== | \$ (3,866,097) ===== |
| Net loss per share | | | | |
| As reported | | | | |
| Basic and diluted | \$ (0.08) ===== | \$ (0.07) ===== | \$ (0.23) ===== | \$ (0.27) ===== |
| Pro forma | | | | |
| Basic and diluted | \$ (0.09) ===== | \$ (0.08) ===== | \$ (0.24) ===== | \$ (0.29) ===== |

The fair values under FAS 123 for options granted were estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions:

| | 2003 ----- | 2002 ----- |
|-----------------------|---------------|---------------|
| Expected life (years) | 3 | 5 |
| Interest rate | 4% | 4% |
| Volatility | 133% | 99% - 157% |
| Dividend yield | 0% | 0% |

NOTE 5 - ADVERTISING CREDITS

On September 8, 2000, the Company issued 914,285 shares (which are fully vested and non-forfeitable) of the Company's common stock in exchange for \$3.2 million face value of advertising credits. These credits were issued by Millenium Media Ltd. and Affluent Media Network, national advertising agencies and media placement brokers. The Company recorded the advertising credits on the date the shares were issued, September 8, 2000, using the Company's quoted common stock price of \$3.3125, totaling \$3,028,569. During the fiscal year ended October 31, 2000, the Company recorded an impairment charge of \$575,542 to reduce the credits to their estimated fair value, and sold a portion of the credits for cash, reducing the balance by an additional \$76,349. The estimated fair value was established at the end of fiscal 2000 using a discount of 25% off the face value, which was based on management's estimate of the dollar value of the credits to be used in settling various outstanding trade obligations. Such credits can be used by the Company to place electronic media and periodical advertisements. The primary use for the media credits is to advertise products and services domestically. As the Company's focus to date has been on foreign traffic, the Company has not utilized any of the media credits. The Company is currently developing domestic products and services and management intends to utilize the media credits to advertise these new services. There is no contractual expiration date for these trade credits and there are no limitations relating to the use of these credits.

NOTE 6 - NOTES PAYABLE

Note Payable with Global Capital Funding Group, L.P.

In November 2002, the Company executed a 12% note payable (the "GC-Note")

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with Global Capital Funding Group, L.P., which provided financing of \$1,250,000. The GC-Note's maturity date is November 8, 2004. The GC-Note is secured by \$1,518,267 of certain property and equipment. In connection with the GC-Note, the Company paid \$47,441 as financing fees, which were capitalized and are being amortized over the life of the GC-Note. During the three and nine months ended July 31, 2003, the Company recorded approximately \$6,000 and \$18,000, respectively, as interest expense relating to these deferred financing fees. The Company also issued to the holder of the GC-Note warrants to acquire an aggregate of 500,000 shares of common stock at an exercise price of \$0.14 per share, which expire on February 28, 2008. The Company recorded a debt discount of approximately \$46,000, the fair value of the warrants, relating to the issuance of the warrants. The Company is amortizing the debt discount over the two year life of the GC-Note. During the three and nine months ended July 31, 2003, the Company has recorded interest expense of approximately \$6,000 and \$17,000, respectively, relating to the warrants.

Note Payable with GCA Strategic Investment Fund Limited

In July 2003, the Company executed a 10% note payable (the "GCA-Note") with GCA Strategic Investment Fund Limited, which provided financing of \$550,000. The GCA-Note's maturity date is December 23, 2003. In the event the GCA-Note is not repaid in full within 10 days of the maturity date, the terms of the GCA-Note shall become the same as those of the Second Debenture (see Note 8). In the event the terms of the GCA-Note become the same as the Second Debenture, the GCA-Note would have a beneficial conversion feature. In accordance with EITF 98-5 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios", the intrinsic value of the beneficial conversion feature has been calculated as approximately \$104,000 at the commitment date using the stock price as of that date. The value of the beneficial conversion feature will only be recorded at the date in which the future event occurs, which, in this case, is 10 days after the maturity date of the note. In connection with the GCA-Note, the Company paid \$35,000 as financing fees, which are being amortized over the life of the GCA-Note. During the three and nine months ended July 31, 2003, the Company recorded approximately \$2,000 as interest expense relating to these deferred financing fees. The Company also issued to the holder of the GCA-Note warrants to acquire an aggregate of 100,000 shares of common stock at an exercise price of \$0.14 per share, which expire on July 24, 2008. The Company recorded a debt discount of approximately \$7,000, the fair value of the warrants, relating to the issuance of the warrants. The Company will amortize the debt discount over the life of the GCA-Note, beginning in the fourth quarter of fiscal 2003.

NOTE 7 - NOTES PAYABLE - RELATED PARTIES

In October 2001, the Company executed 10% convertible notes (the "Notes") with three executives of the Company, which provided financing in the aggregate principal amount of \$1,945,958. The original maturity date of each note was October 24, 2003. In January 2003, the Company extended the maturity date of each note to February 24, 2004. The Notes are secured by certain Company assets. Each Note is convertible into the Company's common stock at the option of the holder at any time. The conversion price is equal to the closing bid price of the Company's common stock on the last trading day immediately preceding the conversion. The Company has calculated the beneficial conversion feature embedded in the Notes in accordance with EITF No. 00-27 and recorded debt discount of approximately \$171,000 which is being amortized over two years. The Company also issued to the holders of the Notes warrants to acquire an aggregate of 1,945,958 shares of common stock at an exercise price of \$0.78 per share, which expire on October 24, 2006. Additional debt discount of approximately \$657,000 was

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recorded during the fourth quarter of fiscal 2001 relating to these warrants. The Company determined the additional debt discount by allocating the relative fair value to the Notes and the warrants. The Company is amortizing the additional debt discount over the life of the Notes. During the three and nine months ended July 31, 2003, the Company has recorded approximately \$102,000 and \$307,000, respectively, of interest expense. In January 2002, an additional \$102,433 was added to the Notes in exchange for an existing note payable. The Company also issued to the holder of the Notes warrants to acquire an additional 102,433 shares of common stock at an exercise price of \$0.75, which expire on January 28, 2007. Additional debt discount, related to these warrants, of approximately \$24,000 was recorded during the first quarter of fiscal 2002. The Company determined the additional debt discount by allocating the relative fair value to the Notes and the warrants. The Company is amortizing the additional debt discount over the remaining life of the Notes. During the three and nine months ended July 31, 2003, the Company has recorded approximately \$3,000 and \$10,000, respectively, of interest expense relating to the warrants. In July 2002, an additional \$300,000 was added to the Notes, representing incremental monies loaned by a shareholder. The Company also issued to the holder of the Notes warrants to acquire an additional 300,000 shares of common stock at an exercise price of \$0.75, which expire on July 8, 2007. Additional debt discount of approximately \$22,000 was recorded as interest expense during the third quarter of fiscal 2002 relating to these warrants. The Company determined the additional debt discount by allocating the relative fair value to the Notes and the warrants.

NOTE 8 - CONVERTIBLE DEBENTURES

Convertible Debenture with Global Capital Funding Group L.P.

In April 2001, the Company executed a 6% convertible debenture (the "Debenture") with Global Capital Funding Group L.P. ("Global"), which provided financing of \$1,000,000. In November 2002, the Debenture's outstanding balance of \$443,000 was paid in full following the issuance of the GC-Note (see Note 6). In November 2002, the remaining unamortized deferred financing fees of approximately \$131,000 on the Debenture were recorded as interest expense. During the three months ended January 31, 2003, Global converted \$50,875 of debt and \$4,859 of accrued interest into approximately 724,000 shares of the Company's common stock.

Convertible Debenture with GCA Strategic Investment Fund Limited

In January 2002, the Company executed a 6% convertible debenture (the "Second Debenture") with GCA Strategic Investment Fund Limited ("GCA"), which provided financing of \$550,000. The Second Debenture's original maturity date was January 28, 2003. The Second Debenture is secured by certain property and equipment held for sale. The conversion price is equal to the lesser of (i) 100% of the volume weighted average of sales price as reported by the Bloomberg L.P. of the common stock on the last trading day immediately preceding the Closing Date and (ii) 85% of the average of the three lowest volume weighted average sales prices as reported by Bloomberg L.P. during the twenty Trading Days immediately preceding but not including the date of the related Notice of Conversion (the "Formula Conversion Price"). In an event of default the amount declared due and payable on the Debenture shall be at the Formula Conversion Price. In connection with the Second Debenture, the Company paid \$92,625 in financing fees, which were amortized over the original life of the Second Debenture. During the three and nine months ended July 31, 2003, the Company has recorded interest expense of approximately \$0 and \$23,000, respectively, relating to these financing fees. The Company calculated the beneficial conversion feature embedded in the Second Debenture in accordance with EITF No. 00-27 and

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recorded approximately \$114,000 as debt discount. This debt discount was amortized over the original life of the Second Debenture. For the three and nine months ended July 31, 2003, the Company has recorded approximately \$0 and \$28,000, respectively, as interest expense relating to the amortization of the debt discount. The Company also issued to the holder of the debenture warrants to acquire an aggregate of 50,000 shares of common stock at an exercise price of \$0.41 per share, which expire on January 28, 2007. The Company recorded debt discount of approximately \$17,000 related to the issuance of the warrants. The Company determined the debt discount by allocating the relative fair value to the Second Debenture and the warrants, and the Company amortized the debt discount over the original life of the Second Debenture. For the three and nine months ended July 31, 2003, the Company has recorded interest expense of approximately \$0 and \$4,000, respectively, relating to the warrants.

In January 2003, the Company and GCA agreed to extend the maturity date of the Second Debenture to November 8, 2004. In consideration for this extension, in February 2003, the Company adjusted the exercise price of the previously issued warrants to \$0.21 per share. The Company also issued to the holder of the Second Debenture warrants to purchase an additional 100,000 shares of common stock also at an exercise price of \$0.21 per share, which expire on February 8, 2008. The Company recorded additional debt discount of approximately \$17,000 related to the warrant exercise price adjustment and the issuance of the new warrants. The Company is amortizing the additional debt discount over the Second Debenture's extension period. For the three and nine months ended July 31, 2003, the Company has recorded interest expense of approximately \$2,000 and \$4,000, respectively, relating to the warrants.

During the three and nine months ended July 31, 2003, GCA converted \$15,000 and \$50,000 of debt, respectively, and \$1,192 and \$3,463 of accrued interest, respectively, into approximately 153,000 and 374,000 shares of the Company's common stock, respectively.

NOTE 9 - IMPAIRMENT OF ASSETS

The Company accounts for the impairment and disposition of long-lived assets other than goodwill in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". In accordance with SFAS No. 144, long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. These evaluations include comparing the future undiscounted cash flows of such assets to their carrying value. The Company recognizes an impairment loss only if an impairment is indicated by its carrying value not being recoverable through undiscounted cash flows. The impairment loss is the difference between the carrying amount and the fair value of the asset estimated using discounted cash flows. During the three months ended July 31, 2003, the Company wrote off certain assets of its German subsidiary which were considered impaired as a result of an insolvency filing during August 2003 (see Note 12). These assets consist of property and equipment totaling \$382,498 and \$301,180 of intangible assets. These assets were determined to be impaired as they have no future revenue stream and no sale value. The write off of these impaired assets is presented as a separate line item in the accompanying consolidated statement of operations.

NOTE 10 - COMMITMENTS AND CONTINGENCIES

On June 12, 2001, Cygnus Telecommunications Technology, LLC ("Cygnus"), filed a patent infringement suit (case no. 01-6052) in the United States

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District court, Central District of California, with respect to the Company's "international reorigination" technology. The injunctive relief that Cygnus sought in this suit has been denied, but Cygnus continues to seek a license fee for the use of the technology. The Company believes that no license fee is required as the technology described in the patent is different from the technology used by the Company.

In August 2002, Cygnus filed a motion for a preliminary injunction to prevent the Company from providing "reorigination" services. The Company filed a cross motion for summary judgment of non-infringement. Both motions were denied. On August 22, 2003, the Company refilled the motion for summary judgment for non-infringement. The Company has not received a decision regarding this filing. The Company intends to continue defending this case vigorously, though its ultimate legal and financial liability with respect to such legal proceeding cannot be estimated with any certainty at this time.

The State of Texas ("State") performed a sales tax audit of the Company's former parent, Canmax Retail Systems ("Canmax"), for the years 1995 to 1999. The State determined that the Company did not properly remit sales tax on certain transactions, including asset purchases and software development projects that Canmax performed for specific customers. The Company's current and former managements filed exceptions, through its outside sales tax consultant, to the State's audit findings, including the non-taxable nature of certain transactions and the failure of the State to credit the Company's account for sales tax remittances. In correspondence from the State in June 2003, the State agreed to consider offsetting remittances received by Canmax during the audit period. The State has refused to consider other potential offsets. Based on this correspondence, the Company recorded an estimated liability of approximately \$350,000 during the quarter ended April 30, 2003. The entire estimated liability of \$350,000 remains accrued at July 31, 2003.

The Company is continuing to pursue its options to appeal the decision by the State. Furthermore, the Company is aggressively pursuing the collection of unpaid sales taxes from former customers of Canmax.

NOTE 11 - RECLASSIFICATIONS

Certain reclassifications were made to the 2002 consolidated financial statements to conform to current year presentation.

NOTE 12 - SUBSEQUENT EVENT

On August 1, 2003, the Company's German Subsidiary, Rapid Link Telecommunications GmbH ("RLGmbH"), received approval for its insolvency filing. RLGmbH has been turned over to a trustee who is responsible for liquidating the operation. The Company believes that creditors of RLGmbH will have no recourse against the Company. Upon completion of the liquidation, the Company will record an entry to remove all remaining assets and liabilities from its books. Past operations of RLGmbH will be categorized on the Consolidated Statement of Operations as from Discontinued Operations.

The following table presents selected unaudited financial information for RLGmbH at July 31, 2003:

| | | |
|-------------------|----|-----------|
| Current Assets | \$ | 405,449 |
| Total Assets | \$ | 405,449 |
| Total Liabilities | \$ | 3,558,682 |

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| | Three Months Ended July 31, 2003 | Nine Months Ended July 31, 2003 |
|----------|-------------------------------------|------------------------------------|
| Revenue | \$ 873,633 | \$ 3,645,829 |
| Net Loss | \$ 949,482 | \$ 1,519,558 |

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

The following discussion and analysis of financial condition and results of operations covers the three and nine months ended July 31, 2003 and 2002 and should be read in conjunction with our financial statements and the notes thereto.

FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to expectations concerning matters that are not historical facts. Words such as "projects", "believe", "anticipates", "estimate", "plans", "expect", "intends", and similar words and expressions are intended to identify forward-looking statements. Although we believe that such forward-looking statements are reasonable, we cannot assure you that such expectations will prove to be correct. Factors that could cause actual results to differ materially from such expectations are disclosed in our annual report on Form 10-K for the year ended October 31, 2002. All of our forward-looking statements are expressly qualified in their entirety by such language and we do not undertake any obligation to update any forward-looking statements. You are also urged to carefully review and consider the various disclosures we have made throughout this report on Form 10-Q which describe certain factors which affect our business.

General

On November 2, 1999, we consummated the DTI Acquisition and, in the second quarter of fiscal 2000, we shifted focus toward our global VoIP strategy. This change in focus has led to a significant shift from our prepaid long distance operations toward higher margin international wholesale and retail telecommunication opportunities. This strategy allows us to form local partnerships with foreign Postal, Telephone and Telegraph companies (those entities responsible for providing telecommunications services in foreign markets and are usually government owned or controlled) and to provide IP enabled services based on the in-country regulatory environment affecting telecommunications and data providers. In the third quarter of fiscal 2000, we further concentrated our efforts toward our global VoIP telecommunications strategy by moving our operations to Los Angeles, California. This refocusing and consolidation of operations has resulted in not only greater savings, but also higher profits and more sustainable revenues. This consolidation and reduction in staff has allowed us to significantly reduce our overhead, and although our operations have not yet produced positive cash flow, we believe that continued cost reductions and moderate revenue growth would allow us to achieve positive results in the near future.

On October 12, 2001, we completed the acquisition from Rapid Link, Incorporated ("Rapid Link") of certain assets and executory contracts of Rapid Link, USA, Inc. and 100% of the common stock of Rapid Link Telecommunications, GmbH, a German company. Rapid Link provided integrated data and voice communications services to both wholesale and retail

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customers around the world. Rapid Link built a large residential retail customer base in Europe and Asia, using Rapid Link's network to make international calls anywhere in the world. Furthermore, Rapid Link developed a VoIP network using Clarent and Cisco technology which we have used to take advantage of wholesale opportunities where rapid deployment and time to market are critical. A significant portion of our revenue in our 2002 fiscal year was derived from the operating assets acquired through our Rapid Link acquisition.

On November 19, 2002 we entered into an agreement with Global Capital Funding Group, L.P. that provided us with a two year loan of \$1.25 million. A portion of the proceeds from this financing were used to pay off the remaining balance of Dial Thru's April 2001 convertible debenture with Global Capital while the remaining \$807,000 has been and will be used for our ongoing working capital needs.

On July 24, 2003, we entered into an agreement with GCA Strategic Investment Fund Limited that provided us with a short-term loan of \$550,000 which has been and will be used for our ongoing working capital needs.

On August 1, 2003, our German Subsidiary, Rapid Link Telecommunications GmbH received approval for it's insolvency filing and has been turned over to a trustee who is responsible for liquidating the operation.

Critical Accounting Policies

The consolidated financial statements include our accounts and those of our majority-owned subsidiaries. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and related footnotes. In preparing these consolidated financial statements, we have made certain estimates and judgments of amounts included in the consolidated financial statements, giving due consideration to materiality. The application of these accounting policies involves the exercise of judgment and use of available information, historical results and other assumptions. As a result, actual results could differ from these estimates.

Revenue Recognition

Our revenues are generated at the time a customer uses our network to make a phone call. We sell our services to small and medium-sized enterprises ("SMEs") and end-users who utilize our network for international re-origination and dial thru services, and to other providers of long distance usage who utilize our network to deliver domestic and international termination of minutes to their own customers. At times, we receive payment from our customers in advance of their usage, which we record as deferred revenue, recognizing revenue as calls are made. The Securities and Exchange Commission's Staff Accounting Bulletin No. 101, "Revenue Recognition", provides guidance on the application of generally accepted accounting principles to selected revenue recognition issues. We have concluded that our revenue recognition policy is appropriate and in accordance with generally accepted accounting principles and SAB No. 101.

Allowance for Uncollectible Accounts Receivable

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. All of our receivables are due from commercial enterprises and residential users in both domestic and international markets. The estimated allowance for uncollectible amounts is based primarily on our evaluation of the financial condition of the customer, and

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our estimation of the customer's willingness to pay amounts due. We review our credit policies on a regular basis and analyze the risk of each prospective customer individually in order to minimize our risk.

Goodwill, Intangible and Other Long-Lived Assets

Property, plant and equipment, certain intangible and other long-lived assets are amortized over their useful lives. Useful lives are based on our estimate of the period that the assets will generate revenue. Goodwill is assessed for impairment at least annually. Goodwill and other intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Financing, Warrants and Amortization of Warrants and Fair Value Determination

We have traditionally financed our operations through the issuance of debt instruments that are convertible into our common stock, at conversion rates at or below the fair market value of our common stock at the time of conversion, and typically include the issuance of warrants. We have recorded these financing transactions in accordance with Emerging Issues Task Force No. 00-27. Accordingly, we recognize the beneficial conversion feature imbedded in the financings and the fair value of the related warrants on the balance sheet as debt discount. The debt discount is amortized over the life of the respective debt instrument.

Carrier Disputes

We review our vendor bills on a monthly basis and periodically dispute amounts invoiced by our carriers. We record cost of revenues excluding these disputed amounts. We review our outstanding disputes on a quarterly basis as part of the overall review of our accrued carrier costs, and adjust our liability based on management's estimate of amounts owed.

Components of Statements of Operations

Revenues

Our primary source of revenue is the sale of voice and fax traffic internationally over our VoIP network, which is measured in minutes, primarily to SMEs, residential users, and wholesale customers. We charge our customers a fee per minute of usage that is dependent on the destination of the call and is recognized in the period in which the call is completed.

Costs of Revenues

Our costs of revenues are termination fees, purchased minutes and fixed costs for specific international and domestic Internet circuits and private lines used to transport our minutes. Termination fees are paid to local service providers and other international and domestic carriers to terminate calls received from our network. This traffic is measured in minutes, at a negotiated contract cost per minute.

General and Administrative Expenses

General and administrative expenses include salaries, payroll taxes, benefit expenses and related costs for general corporate functions, including executive management, finance and administration, legal and regulatory, information technology and human resources. Sales and marketing expenses include salaries, payroll taxes, benefits and commissions that we pay for sales personnel and advertising and marketing programs, including expenses relating to our outside public relations firms. Interest expense

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and financing costs relate primarily to the amortization of deferred financing fees and debt discounts on our various debt instruments.

RESULTS OF OPERATIONS - COMPARISON OF THE THREE AND NINE MONTHS ENDED JULY 31, 2003 AND 2002

REVENUES

For the three months ended July 31, 2003, we generated revenues of \$5,474,000, a decrease of \$665,000, or 11%, from the same period in 2002. For the three months ended July 31, 2003, 43% and 57% of our revenues were derived from our retail and wholesale customers, respectively, compared to 58% and 42%, respectively, for the three months ended July 31, 2002. In absolute dollars, our wholesale revenues have increased by 19% from the three months ended July 31, 2002 compared to the three months ended July 31, 2003, while our retail revenues have decreased by 33% over the comparable period.

For the nine months ended July 31, 2003, we generated revenues of \$17,142,000 a decrease of \$1,670,000, or 9%, over the same period in 2002. For the nine months ended July 31, 2003, our retail and wholesale customers each accounted for 50% of our revenues, compared to 60% and 40%, respectively, for the nine months ended July 31, 2002. In absolute dollars, our wholesale revenues have increased by 15% from the nine months ended July 31, 2002 compared to the nine months ended July 31, 2003, while our retail revenues have decreased by 25% over the comparable period.

The decrease in retail revenues for the three and nine months ended July 31, 2003 is primarily attributable to increased competition in our largest foreign markets, including competition from the incumbent phone company in each market. The increase in wholesale revenues for the three and nine months ended July 31, 2003 is attributable to additions to our wholesale sales force which focuses on developing greater wholesale opportunities. We are exploring opportunities to grow our retail business through use of our advertising credits and newspaper advertising.

OPERATING EXPENSES

Costs of revenues: During the three months ended July 31, 2003 and 2002, we incurred total costs of revenues of \$4,049,000 and \$4,128,000, respectively, or 74% and 67% of revenues, respectively. During the nine months ended July 31, 2003 and 2002, we incurred total costs of revenues of \$12,723,000 and \$12,755,000, respectively, or 74% and 68% of revenues, respectively. Our costs of revenues as a percentage of revenues has increased due to a decline in our retail traffic which realizes higher margins than our wholesale traffic. Costs of revenues as a percentage of revenues will fluctuate, from period to period, depending on the traffic mix between our wholesale and retail products.

General and Administrative Expenses: During the three months ended July 31, 2003 and 2002, we incurred total general and administrative expenses of \$1,234,000 and \$1,768,000, respectively, or 23% and 29% of revenues, respectively. During the nine months ended July 31, 2003 and 2002, we incurred total general and administrative expenses of \$4,060,000 and \$5,741,000, respectively, or 24% and 31% of revenues, respectively. Included in general and administrative expenses is bad debt expense of \$1,000 and \$136,000 for the three months ended July 31, 2003 and 2002, respectively, and \$30,000 and \$550,000 for the nine months ended July 31, 2003 and 2002, respectively. Bad debt expense for the nine months ended July 31, 2002 is primarily attributable to non-payment from one wholesale customer. We have implemented strict credit policies and systems to closely monitor our wholesale traffic daily to reduce the risk of bad debt. We have

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further reduced our general and administrative costs by approximately \$309,000 and \$900,000, for the three and nine months ended July 31, 2003, respectively, through the elimination of personnel and personnel related costs. We review our general and administrative expenses regularly, and continue to manage the costs accordingly to support the current and anticipated future business.

Sales and Marketing Expenses: During the three months ended July 31, 2003 and 2002, sales and marketing expenses were \$215,000 and \$375,000, respectively, or 4% and 6% of revenues, respectively. During the nine months ended July 31, 2003 and 2002, sales and marketing expenses were \$802,000 and \$1,080,000, respectively, or 5% and 6% of revenues, respectively. A majority of our revenues are generated by outside agents or through newspaper and periodical advertising, which is managed by a small in-house sales and marketing organization. We will continue to focus our sales and marketing efforts on newspaper and periodical advertising and agent related expenses to generate additional revenues. The use of our advertising credits is expected to increase sales and marketing expenses in absolute dollars in future periods.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expenses were \$430,000 and \$596,000 for the three months ended July 31, 2003 and 2002, respectively, and \$1,397,000 and \$1,889,000 for the nine months ended July 31, 2003 and 2002, respectively. Depreciation and amortization has decreased as a portion of our assets still in use have become fully depreciated, including a majority of the assets acquired from Rapid Link. A majority of our depreciation and amortization expense relates to the equipment utilized in our VoIP network.

WRITE DOWN OF IMPAIRED ASSETS

In connection with the insolvency filing of our Germany Subsidiary, Rapid Link Telecommunications, GmbH, on August 1, 2003, we reviewed the carrying value of its long term assets, principally property and equipment and intangibles and determined that they were impaired. Accordingly, during the three months ended July 31, 2003, we recorded an impairment charge totaling \$684,000 relating to these impaired assets.

SALES TAX SETTLEMENT

We recorded an expense of \$350,000 during the quarter ended April 30, 2003. This estimated cost is attributable to audit findings on our former parent, Canmax Retail Systems, from the State of Texas for the years 1995 to 1999. The State of Texas determined that we did not properly remit sales tax on certain transactions. Our current and former managements have filed exceptions, through our outside sales tax consultant, to the State's audit findings. (See Note 10.)

INTEREST EXPENSE AND FINANCING COSTS

Interest expense and financing costs were \$205,000 and \$351,000 for the three months ended July 31, 2003 and 2002, respectively, and \$852,000 and \$932,000 for the nine months ended July 31, 2003 and 2002, respectively. Interest expense and financing costs are primarily attributable to interest amounts due on notes, the amortization of deferred financing fees and debt discounts relating to our various debt instruments.

NET LOSS

As a result of the foregoing, for the three months ended July 31, 2003 and 2002, we incurred a net loss of \$1,347,000 or \$0.08 per share and \$1,083,000

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or \$0.07 per share, respectively. For the nine months ended July 31, 2003 and 2002, we incurred a net loss of \$3,721,000 or \$0.23 per share and \$3,608,000 or \$0.27 per share, respectively.

LIQUIDITY AND CAPITAL RESOURCES

The growth model for our business is scaleable, but the rate of growth is dependent on the availability of future financing for capital resources. Our funding of additional infrastructure development will be provided through the operations of our telecommunications business and externally through debt and/or equity offerings. We plan to obtain vendor financing for any equipment needs associated with expansion. We believe that, with sufficient capital, we can significantly accelerate our growth plan. Our failure to obtain additional financing could delay the implementation of our business plan and have a material adverse effect on our business, financial condition and operating results.

At July 31, 2003, we had cash and cash equivalents of \$1,055,000 an increase of \$566,000 from the balance at October 31, 2002. As of July 31, 2003, we had a working capital deficit of \$10,069,000, compared to a working capital deficit of \$8,804,000 at October 31, 2002. As of July 31, 2003, our current assets of \$2,487,000 included net accounts receivable of \$1,204,000, which has decreased from the balance of \$1,370,000 at October 31, 2002 as a result of the Company implementing more stringent credit requirements during fiscal 2002.

Net cash used in operating activities was \$416,000 for the nine months ended July 31, 2003, compared to \$1,220,000 for the nine months ended July 31, 2002. The net cash used in operating activities for the nine months ended July 31, 2003 was primarily due to a net loss of \$3,721,000 adjusted for: non-cash interest expense of \$543,000; depreciation and amortization of \$1,397,000; effects of changes in foreign exchange rates of (\$340,000); write down of impaired assets of \$683,000; and net changes in operating assets and liabilities of \$991,000. For the nine months ended July 31, 2002, the net cash used in operating activities was primarily due to a net loss of \$3,608,000 adjusted for: bad debt expense of \$550,000; depreciation and amortization of \$1,889,000; non-cash interest expense of \$684,000; effects of changes in foreign exchange rates of (\$100,000); and net changes in operating assets and liabilities of (\$640,000).

During the nine months ended July 31, 2003, net cash used in investing activities was \$139,000, compared to net cash provided by investing activities of \$1,161,000 for the nine months ended July 31, 2002. The net cash used in investing activities for the nine months ended July 31, 2003 is due to capital expenditures of \$139,000. For the nine months ended July 31, 2002, net cash provided by investing activities is primarily attributable to a refund of a license fee previously paid on behalf of our German subsidiary of \$1,425,000 offset by capital expenditures of \$264,000.

Net cash provided by financing activities for the nine months ended July 31, 2003, totaled \$1,121,000, compared to \$631,000 for the nine months ended July 31, 2002. For the nine months ended July 31, 2003, significant components of net cash provided by financing activities include \$1,800,000 in net proceeds from notes payable, offset by \$443,000 in payments on convertible debentures, \$154,000 in payments on capital leases, and \$82,000 of deferred financing fees. For the nine months ended July 31, 2002, the significant components of net cash provided by financing activities include \$550,000 in proceeds from the issuance of a convertible debenture, \$300,000 in proceeds from the issuance of a related party note, offset by \$141,000 in payments on capital leases, and \$93,000 of deferred financing fees.

We are subject to various risks in connection with the operation of our

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business including, among other things, (i) changes in external competitive market factors, (ii) inability to satisfy anticipated working capital or other cash requirements, (iii) changes in the availability of transmission facilities, (iv) changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the market, (v) various competitive factors that may prevent us from competing successfully in the marketplace, (vi) our lack of liquidity, and (vii) our ability to raise additional capital. We have an accumulated deficit of approximately \$43.7 million as of July 31, 2003, as well as a working capital deficit of approximately \$10.1 million. Funding of our working capital deficit, current and future operating losses, and expansion will require continuing capital investment. Our strategy is to fund these cash requirements through operations, debt facilities and additional equity financing. As of the date of this report:

1. we obtained additional debt financing of \$1,250,000 in November 2002, a portion of which was used to fully pay the April 11, 2001 convertible debenture with Global Capital Funding Group L.P.
2. we and GCA Strategic Investment Fund Limited agreed to extend the maturity date of the January 2002 debenture from January 28, 2003 to November 8, 2004.
3. we obtained additional financing of \$550,000 in July 2003.

Although we have been able to arrange debt facilities and equity financing to date, there can be no assurance that sufficient debt or equity financing will continue to be available in the future or that it will be available on terms acceptable to us. Failure to obtain sufficient capital could materially affect the Company's operations and expansion strategies. As a result of the aforementioned factors and related uncertainties, there is doubt about our Company's ability to continue as a going concern.

Our current capital expenditure requirements are not significant, primarily due to the equipment acquired from Rapid Link. Our capital expenditures for the nine months ended July 31, 2003 were \$139,000 and we do not anticipate significant spending for the remainder of fiscal 2003.

In April 2001, we executed a 6% convertible debenture with Global Capital Funding Group L.P, which provided financing of \$1,000,000. During November 2002, the Debenture's outstanding balance of \$443,000 was paid in full.

In October 2001, we executed 10% convertible notes (the "Notes") with three of our executives, who provided an aggregate financing of \$1,945,958. The original maturity date of each note was October 24, 2003. In January 2003, we extended the maturity date of each note to February 24, 2004. The Notes are secured by certain Company assets and are convertible into our common stock at any time prior to maturity. The conversion price is equal to the closing bid price of our common stock on the last trading day immediately preceding the conversion. We also issued to the holders of the Notes warrants to acquire an aggregate of 1,945,958 shares of common stock at an exercise price of \$0.78 per share, which expire on October 24, 2006. In January 2002, an additional \$102,433 was added to the Notes in exchange for an existing note payable. We also issued to the holder of the Notes warrants to acquire an additional 102,433 shares of common stock at an exercise price of \$0.75, which expire on January 28, 2007. In July 2002, an additional \$300,000 was added to the Notes, representing incremental monies loaned by an executive. We also issued to the holder of the Notes, warrants to acquire an additional 300,000 shares of common stock at an exercise price of \$0.75, which expire on July 8, 2007.

In January 2002, we executed a 6% convertible debenture (the "Second Debenture") with Global Capital Funding Group L.P, which provided financing of \$550,000. The Second Debenture's original maturity date was January 28,

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2003. The conversion price is equal to the lesser of (i) 100% of the volume weighted average of sales price as reported by the Bloomberg L.P. of the common stock on the last trading day immediately preceding the Closing Date ("Fixed Conversion Price") and (ii) 85% of the average of the three (3) lowest volume weighted average sales prices as reported by Bloomberg L.P. during the twenty (20) Trading Days immediately preceding but not including the date of the related Notice of Conversion ("the "Formula Conversion Price"). In an event of default the amount declared due and payable on the Second Debenture shall be at the Formula Conversion Price. We also issued to the holder of the Second Debenture warrants to acquire 50,000 shares of common stock at an exercise price of \$0.41 per share which expire on January 28, 2007. In January 2003, we extended the maturity date of the Second Debenture to November 8, 2004. In consideration for this extension, in February 2003, we adjusted the exercise price of the previously issued warrants to \$0.21 per share and issued additional warrants to purchase 100,000 shares of common stock also at an exercise price of \$0.21 per share, which warrants expire on February 8, 2008.

To the extent that these Convertible Debentures are converted into common stock, a significant number of shares of common stock may be sold into the market, which could decrease the price of our common stock and encourage shorts sales by selling security holders or others. Short sales could place further downward pressure on the price of our common stock. In that case, we could be required to issue an increasingly greater number of shares of our common stock upon future conversions of these Convertible Debentures, sales of which could further depress the price of our common stock.

In November 2002, we executed a 12% note payable (the "GC-Note") with Global Capital Funding Group, L.P., which provided financing of \$1,250,000. The GC-Note's maturity date is November 8, 2004. The GC-Note is secured by \$1,518,267 of certain property and equipment. We also issued to the holder of the GC-Note warrants to acquire 500,000 shares of common stock at an exercise price of \$0.14 per share, which expire on February 28, 2008.

In July 2003, we executed a 10% note payable (the "GCA-Note") with GCA Strategic Investment Fund Limited, which provided financing of \$550,000. The GCA-Note's maturity date is December 23, 2003. In the event the GCA-Note is not repaid in full within 10 days of the maturity date, the terms of the GCA-Note shall become the same as those of the Second Debenture. We also issued to the holder of the GCA-Note warrants to acquire 100,000 shares of common stock at an exercise price of \$0.14 per share, which expire on July 24, 2008.

On August 1, 2003, our German Subsidiary, Rapid Link Telecommunications GmbH ("RLGmbH"), received approval for its insolvency filing. RLGmbH has been turned over to a trustee who is responsible for liquidating the operation. We believe that creditors of RLGmbH will have no recourse against us. During the quarter ending September, 30, 2003, the assets and liabilities of RLGmbH will be written down to their fair market value and categorized on the Consolidated Balance Sheet as Discontinued Operations. Past operations of RLGmbH will be categorized on the Consolidated Statement of Operations as from Discontinued Operations.

The following summarizes our obligations at July 31, 2003, and the effect such obligations are expected to have on our liquidity and cash flow in future periods (excluding interest due of \$601,768 as of July 31, 2003 on the Company's "Other Commercial Commitments"):

Contractual
Obligations

Payments Due by Period

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| | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
|-------------------------------|-------------|---------------------|--------------|--------------|------------------|
| Contractual lease obligations | \$ 308,307 | \$ 302,511 | \$ 5,796 | \$ - | \$ - |
| Operating leases | \$ 958,902 | \$ 454,339 | \$ 504,563 | \$ - | \$ - |
| Total contractual obligations | \$1,267,209 | \$ 756,850 | \$ 510,359 | \$ - | \$ - |
| Other Commercial Commitments | Total | Less than 1 year | 1-3 years | 4-5 years | After 5 years |
| Convertible Debentures | \$ 500,000 | \$ - | \$ 500,000 | \$ - | \$ - |
| Notes payable | \$1,800,000 | \$ 550,000 | \$1,250,000 | \$ - | \$ - |
| Related party notes | \$2,348,401 | \$2,348,401 | \$ - | \$ - | \$ - |
| | \$4,648,401 | \$2,898,401 | \$1,750,000 | \$ - | \$ - |

Risk Factors

Our cash flow may not be sufficient to satisfy our cost of operations

For the nine months ended July 31, 2003 and years ended October 31, 2002 and 2001, we recorded net losses of approximately \$3.7 million, \$4.7 million and \$2.7 million, respectively, on revenues of approximately \$17.1 million, \$24.9 million and \$7.0 million, respectively. As a result, we currently have a working capital deficit of over \$10 million. In addition, we have a significant amount of trade payables and accrued liabilities, of which approximately 21% is past due, excluding disputes for overcharges with our underlying carriers of approximately \$250,000. To be able to service our debt obligations over the course of the 2003 fiscal year we must generate significant cash flow and obtain additional financing. If we are unable to do so or otherwise to obtain funds necessary to make required payments on our trade debt and other indebtedness, we may not be able to continue our operations.

Our operating history makes it difficult to accurately assess our general prospects in the VoIP portion of the telecommunications industry and the effectiveness of our business strategy. In addition, we have limited meaningful historical financial data upon which to forecast our future sales and operating expenses. Our future performance will also be subject to prevailing economic conditions and to financial, business and other factors. Accordingly, we cannot assure you that we will successfully implement our business strategy or that our actual future cash flows from operations will be sufficient to satisfy our debt obligations and working capital needs.

To implement our business strategy, we will also need to seek additional financing. There is no assurance that adequate levels of additional financing will be available at all or on acceptable terms. In addition, any additional financing will likely result in significant dilution to our existing stockholders. If we are unable to obtain additional financing on terms that are acceptable to us, we could be forced to dispose of assets to make up for any shortfall in the payments due on our debt under circumstances that might not be favorable to realizing the highest price for those assets. A portion of our assets consist of intangible assets, the value of which will depend upon a variety of factors, including the success of our business. As a result, if we do need to sell any of our assets, we

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cannot assure you that our assets could be sold quickly enough, or for amounts sufficient, to meet our obligations.

We face competition from numerous, mostly well-capitalized sources

The market for our products and services is highly competitive. We face competition from multiple sources, many of which have greater financial resources and a substantial presence in our markets and offer products or services similar to our services. Therefore, we may not be able to successfully compete in our markets, which could result in a failure to implement our business strategy, adversely affecting our ability to attract and retain new customers. In addition, competition within the industries in which we operate is characterized by, among other factors, price and the ability to offer enhanced services. Significant price competition would reduce the margins realized by us in our telecommunications operations. Many of our competitors have greater financial resources to devote to research, development and marketing, and may be able to respond more quickly to new or merging technologies and changes in customer requirements. If we are unable to provide value-added Internet products and services then we will be unable to compete in certain segments of the market, which could have an adverse impact on our business.

The regulatory environment in our industry is very uncertain

The legal and regulatory environment pertaining to the Internet is uncertain and changing rapidly as the use of the Internet increases. For example, in the United States, the FCC is considering whether to impose surcharges or additional regulations upon certain providers of Internet telephony.

In addition, the regulatory treatment of Internet telephony outside of the United States varies from country to country. There can be no assurance that there will not be legally imposed interruptions in Internet telephony in these and other foreign countries. Interruptions or restrictions on the provision of Internet telephony in foreign countries may adversely affect our ability to continue to offer services in those countries, resulting in a loss of customers and revenues.

New regulations could increase the cost of doing business over the Internet or restrict or prohibit the delivery of our products or services using the Internet. In addition to new regulations being adopted, existing laws may be applied to the Internet. Newly existing laws may cover issues that include sales and other taxes, access charges, user privacy, pricing controls, characteristics and quality of products and services, consumer protection, contributions to the Universal Service Fund, an FCC-administered fund for the support of local telephone service in rural and high-cost areas, cross-border commerce, copyright, trademark and patent infringement, and other claims based on the nature and content of Internet materials.

Changes in the technology relating to Internet telephony could threaten our operations

The industries in which we compete are characterized, in part, by rapid growth, evolving industry standards, significant technological changes and frequent product enhancements. These characteristics could render existing systems and strategies obsolete and require us to continue to develop and implement new products and services, anticipate changing consumer demands and respond to emerging industry standards and technological changes. No assurance can be given that we will be able to keep pace with the rapidly changing consumer demands, technological trends and evolving industry standards.

We need to develop and maintain strategic relationships around the world to

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be successful

Our international business, in part, is dependent upon relationships with distributors, governments or providers of telecommunications services in foreign markets. The failure to develop or maintain these relationships could have an adverse impact on our business.

We rely on two key senior executives

Our success is dependent on our senior management team of John Jenkins and Allen Sciarillo and our future success will depend, in large part, upon our ability to retain these two individuals.

The expansion of our VoIP product offerings is essential to our survival

We intend to expand our VoIP network and the range of enhanced telecommunications services that we provide. Our expansion prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in new and rapidly evolving markets.

Our OTC Bulletin Board listing negatively affects the liquidity of our common stock

Our common stock currently trades on the OTC Bulletin Board. Therefore, no assurances can be given that a liquid trading market will exist at the time any investor desires to dispose of any shares of the our common stock. In addition, our common stock is subject to the so-called "penny stock" rules that impose additional sales practice requirements on broker-dealers who sell such securities to persons other than established customers and accredited investors (generally defined as an investor with a net worth in excess of \$1 million or annual income exceeding \$200,000, or \$300,000 together with a spouse). For transactions covered by the penny stock rules, a broker-dealer must make a suitability determination for the purchaser and must have received the purchaser's written consent to the transaction prior to sale. Consequently, both the ability of a broker-dealer to sell our common stock and the ability of holders of our common stock to sell their securities in the secondary market may be adversely affected. The Securities and Exchange Commission has adopted regulations that define a "penny stock" to be an equity security that has a market price of less than \$5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require the delivery, prior to the transaction, of a disclosure schedule relating to the penny stock market. The broker-dealer must disclose the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is to sell the securities as a market maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We provide services primarily to customers located outside of the U.S., thus, our financial results could be impacted by foreign currency exchange rates and market conditions abroad. However, the aggregate impact of any likely exchange rate fluctuations would be immaterial as most of our services are paid for in U.S. dollars. A strong dollar could make the cost of our services more expensive than the services of non-U.S. based providers in foreign markets. We have not used derivative instruments to hedge our foreign exchange risks though we may choose to do so in the future.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. Our management carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective. Disclosure controls and procedures mean our controls and other procedures that are designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls. There have been no changes in our internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

2.1 Agreement and Plan of Merger dated as of January 30, 1998, among Canmax Inc., CNMX MergerSub, Inc. and US Communications Services, Inc. (filed as Exhibit 2.1 to Form 8-K dated January 30, 1998 (the "USC 8-K"), and incorporated herein by reference)

2.2 Rescission Agreement dated June 15, 1998 among Canmax Inc., USC and former principals of USC (filed as Exhibit 10.1 to Form 8-K dated January 15, 1998 (the "USC Rescission 8-K"), and incorporated herein by reference)

2.3 Asset Purchase Agreement by and among Affiliated Computed Services, Inc., Canmax and Canmax Retail Systems, Inc. dated September 3, 1998 (filed as Exhibit 10.1 to the Company's Form 8-K dated December 7, 1998 and incorporated herein by reference)

2.4 Asset Purchase Agreement dated November 2, 1999 among ARDIS Telecom & Technologies, Inc., Dial Thru International Corporation, a Delaware corporation, Dial Thru International Corporation, a California corporation, and John Jenkins (filed as Exhibit 2.1 to the Company's Current Report on Form 8-K dated November 2, 1999 and incorporated herein by reference)

2.5 Stock and Asset Purchase Agreement, dated as of September 18, 2001, by and among Rapid Link USA, Inc., Rapid Link Inc., and Dial Thru International Corporation. (filed as Exhibit 2.1 to the Company's Form 8-K dated October 29, 2001 and incorporated herein by reference)

2.6 First Amendment to Stock and Asset Purchase Agreement, dated as of September 21, 2001, by and among Rapid Link USA, Inc., Rapid Link Inc., and

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Dial Thru International Corporation. (filed as Exhibit 2.2 to the Company's Form 8-K dated October 29, 2001 and incorporated herein by reference)

2.7 Second Amendment to Stock and Asset Purchase Agreement, dated as of October 12, 2001, by and among Rapid Link USA, Inc., Rapid Link Inc., and Dial Thru International Corporation. (filed as Exhibit 2.3 to the Company's Form 8-K dated October 29, 2001 and incorporated herein by reference)

2.8 Third Amendment to Stock and Asset Purchase Agreement, dated as of October 30, 2001, by and among Rapid Link USA, Inc., Rapid Link Inc., and Dial Thru International Corporation. (filed as Exhibit 2.4 to the Company's Form 8-K dated December 28, 2001 and incorporated herein by reference)

2.9 Fourth Amendment to Stock and Asset Purchase Agreement, dated as of November 30, 2001, by and among Rapid Link USA, Inc., Rapid Link Inc., and Dial Thru International Corporation. (filed as Exhibit 2.5 to the Company's Form 8-K dated December 28, 2001 and incorporated herein by reference)

3.1 Certificate of Incorporation, as amended (filed as Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1999 (the "1999 Form 10-K") and incorporated herein by reference)

3.2 Amended and Restated Bylaws of Dial Thru International Corporation (filed as Exhibit 3.2 to the 1999 Form 10-K and incorporated herein by reference)

31.1 Certification of the Chief Executive Officer, dated September 15, 2003, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of the Chief Financial Officer, dated September 15, 2003, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of the Chief Executive Officer, dated September 15, 2003, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of the Chief Financial Officer, dated September 15, 2003, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) The following reports on Form 8-K were filed or required to be filed for the last quarter.

None.

SIGNATURES

Pursuant to 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.

DIAL THRU INTERNATIONAL CORPORATION

By: /s/ Allen Sciarillo

Allen Sciarillo
Executive Vice President and Chief Financial
Officer (Principal Financial and Principal
Accounting Officer)

Dated September 15, 2003

