

DIAL THRU INTERNATIONAL CORP
Form 10-Q
June 14, 2002

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**United States
Securities and Exchange Commission**

Washington, D.C. 20549

FORM 10-Q

ý **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Period Ended April 30, 2002**

or

o **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
(State or other jurisdiction of
incorporation or organization)

75-2461665
(I.R.S. Employer Identification No.)

17383 Sunset Boulevard,, Suite 350
Los Angeles, California
(Address of principal executive offices)

90272
(Zip Code)

(310) 566-1700

(Registrant's telephone number, including area code)

(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 ý No o

No independent accountant has reviewed the financial statements included in this Form 10-Q because the registrant's independent accountant, Arthur Andersen LLP, was unable to perform the review. Please see additional information on Page 1.

As of June 13, 2002, 14,748,142 shares of common stock, \$.001 par value per share, were outstanding.

No independent accountant has reviewed the financial statements included in this Form 10-Q because the Company's independent accountant, Arthur Andersen LLP, was unable to perform the review. Although the Company has not as yet formally dismissed Arthur Andersen

LLP, we are in the process of interviewing alternate independent accounting firms which are able to review these financial statements. As soon as the Company decides on which independent accounting firm to use going-forward, the financial statement review will occur. We anticipate this review occurring within the next sixty days. Upon completion of the review, if there is a change in these financial statements, the Company will file an amended report on Form 10-Q containing the reviewed financial statements, a discussion of any material changes from the unreviewed financial statements and any other section of the Form 10-Q that is amended to reflect any changes in the financial statements.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	April 30, 2002	October 31, 2001
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 487,116	\$ 94,985
Trade accounts receivable, net of allowance for doubtful accounts of \$430,205 at January 31, 2002 and \$228,729 at October 31, 2001	1,928,287	1,832,768
Prepaid expenses and other	431,903	43,612
	<u>2,847,306</u>	<u>1,971,365</u>
Total current assets	2,847,306	1,971,365
PROPERTY AND EQUIPMENT, net	4,059,353	5,135,027
PROPERTY AND EQUIPMENT HELD FOR SALE	320,307	320,307
ADVERTISING CREDITS, net	2,376,678	2,376,678
OTHER ASSETS	200,839	78,762
GOODWILL AND OTHER INTANGIBLE ASSETS, net of amortization of \$386,147 at April 30, 2002 and \$291,202 at October 31, 2001	1,827,320	2,762,010
	<u>11,631,803</u>	<u>12,644,149</u>
TOTAL ASSETS	\$ 11,631,803	\$ 12,644,149
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Convertible debenture, net of debt discount of \$454,687 at April 30, 2002	\$ 725,313	\$
Current portion of capital leases	332,830	385,787
Trade accounts payable	4,388,464	5,037,338
Accrued carrier costs	1,124,109	917,415
Accrued liabilities	2,577,077	1,416,159
Deferred revenue	817,147	738,576
Note payable to shareholder		102,443
	<u>9,964,940</u>	<u>8,597,718</u>
Total current liabilities	9,964,940	8,597,718
CAPITAL LEASE, NET OF CURRENT	121,320	286,102

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	April 30, 2002	October 31, 2001
NOTES PAYABLE RELATED PARTY, net of debt discount of \$634,936 at April 30, 2002 and \$819,470 at October 31, 2001	1,413,465	1,126,488
CONVERTIBLE DEBENTURE, net of debt discount of \$445,155 at October 31, 2001		554,845
SHAREHOLDERS' EQUITY		
Preferred stock, \$.001 par value, 10,000,000 shares authorized, none issued and outstanding		
Common stock, 44,169,100 shares authorized; \$.001 par value; 13,639,480 shares issued at April 30, 2002 and 12,119,090 at October 31, 2001	13,640	12,119
Additional paid-in capital	38,711,789	38,174,588
Accumulated deficit	(38,446,832)	(35,947,213)
Accumulated other comprehensive income	(74,569)	(88,548)
Treasury stock, 12,022 common shares at cost	(54,870)	(54,870)
Subscription receivable common stock	(17,080)	(17,080)
Total shareholders' equity	132,078	2,078,996
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 11,631,803	\$ 12,644,149

The accompanying notes are an integral part of these statements.

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DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

	THREE MONTHS ENDED APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2002	2001	2002	2001
REVENUES	\$ 6,086,154	\$ 903,639	\$ 12,672,908	\$ 1,794,258
COSTS AND EXPENSES				
Cost of revenues	4,250,549	609,367	8,796,293	1,276,373
Sales & marketing	339,437	223,001	704,982	425,575
Non-cash sales and marketing expense				258,616
General & administrative	1,972,694	598,259	3,973,105	1,211,609
Depreciation and amortization	615,550	155,612	1,293,083	302,502
Total cost and expenses	7,178,230	1,586,239	14,767,463	3,474,675
Operating loss	(1,092,076)	(682,600)	(2,094,555)	(1,680,417)
OTHER INCOME (EXPENSES)				
Interest and financing costs	(313,377)	(159,207)	(581,818)	(475,195)
Interest income (expense)		(12,730)		(15,514)
Other related to settlement of disputes		97,186		1,789,373

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	THREE MONTHS ENDED APRIL 30,		SIX MONTHS ENDED APRIL 30,	
Foreign exchange	191,727		168,201	
Write off of investment in marketable securities		(435,820)		(435,820)
Gain on sales of equipment			8,553	
Total other income (expense)	(121,650)	(510,571)	(405,064)	862,844
NET LOSS	\$ (1,213,726)	\$ (1,193,171)	\$ (2,499,619)	\$ (817,573)
LOSS PER SHARE:				
Basic and diluted loss per share	\$ (0.09)	\$ (0.11)	\$ (0.19)	\$ (0.08)
SHARES USED IN THE CALCULATION OF PER SHARE AMOUNTS:				
Basic common shares	13,506,173	10,571,756	13,111,620	10,230,024

The accompanying notes are an integral part of these statements.

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DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	SIX MONTHS ENDED APRIL 30,	
	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (2,499,619)	\$ (817,573)
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	258,616
Bad debt expense	413,797	
Non-cash interest expense	422,600	475,195
Write off of investment in marketable securities		435,820
Depreciation and amortization	1,293,083	302,502
Other income related to settlement of dispute		(1,789,373)
(Increase) decrease in:		
Trade accounts receivable	(509,316)	(11,949)
Prepaid expenses and other	(388,291)	28,341
Other assets	(122,076)	10,000
Increase (decrease) in:		
Trade accounts payable	(1,178,370)	386,441
Accrued carrier costs	206,694	
Accrued liabilities	1,160,918	(216,508)

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	SIX MONTHS ENDED APRIL 30,	
	78,571	29,815
Deferred revenue	78,571	29,815
Net cash used in operating activities	(1,116,812)	(908,673)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(142,719)	(21,215)
Refund of license fee	1,424,899	
Net cash provided by (used in) investing activities	1,282,180	(21,215)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from shareholder note payable		599,577
Proceeds from convertible debentures	457,375	
Proceeds from notes payable		1,000,000
Payments on shareholder note payable		(189,619)
Payments on capital leases	(217,739)	(23,178)
Proceeds from exercise of stock options		34,344
Effects of changes in foreign exchange rates	(12,873)	
Net cash provided by financing activities	226,763	1,421,124
NET INCREASE (DECREASE) IN CASH	392,131	491,236
Cash and cash equivalents at beginning of period	94,985	73,867
Cash and cash equivalents at end of period	\$ 487,116	\$ 565,103
SUPPLEMENTAL SCHEDULE OF NON CASH INVESTING AND FINANCING ACTIVITIES		
Conversion of convertible debenture to common stock	\$ 370,000	\$
Warrants issued for debt	154,973	0
Cash paid for interest	11,174	0
Cash paid for taxes	6,681	0
Conversion of debt to equity	0	1,000,000
Additional shares issued as purchase consideration	0	1,031,200
Convertible debt issued with below market conversion feature	0	329,931

The accompanying notes are an integral part of these statements.

**DIAL THRU INTERNATIONAL CORPORATION
AND SUBSIDIARIES**

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

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The condensed consolidated financial statements of Dial Thru International Corporation and its subsidiaries included in this Form 10-Q are unaudited. Accordingly, they 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 six month periods ended April 30, 2002 and 2001 have been included. Operating results for the three and six month periods ended April 30, 2002 are not necessarily indicative of the results that may be expected for the year ending October 31, 2002. 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 year ended October 31, 2001.

The Company is a full service, facility-based provider of communication products to small and medium size businesses, both domestically and internationally. The Company now 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 companies 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 is also introducing 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.

The Company reviews its vendor bills on a monthly basis and periodically disputes amounts invoiced by its carriers. Prior to the second quarter of fiscal 2001, the Company recorded as trade accounts payable the entire amounts owed to its vendors, including amounts in dispute. Any disputes resolved and credited to the Company were recorded as other income at the time the credit was issued. The Company subsequently changed its policy to record cost of revenues excluding disputed amounts. The Company reviews its outstanding disputes on a quarterly basis as part of the overall review of its accrued carrier costs, and adjusts its liability based on management's estimate of amounts owed. At April 30, 2002, the Company had approximately \$750,000 of disputes with certain vendors.

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NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

EARNINGS (LOSS) PER SHARE

The shares issuable upon the exercise of stock options and warrants, and convertible debentures are excluded from the calculation of net earnings (loss) per share as their effect on net loss would be antidilutive.

REVENUE RECOGNITION AND COSTS OF REVENUES

Revenues generated by international re-origination, dial-thru services and international wholesale termination are based on minutes of customer usage. The Company records payments received in advance as deferred revenue until such services are provided. This policy applies to all international re-origination, dial-thru services and wholesale revenues and is the primary source of the Company's revenue going forward.

NOTE 3 CONCENTRATION OF CREDIT RISK AND SIGNIFICANT CUSTOMERS

The Company has an outstanding receivable from a customer of \$215,853, which is overdue by approximately six months and has been reserved in full as of April 30, 2002.

NOTE 4 NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. In addition, companies are required to review goodwill and intangible assets reported in connection with prior acquisitions, possibly disaggregate and report separately previously identified intangible assets and possibly reclassify certain intangible assets into goodwill. SFAS No. 142 establishes new guidelines for accounting for goodwill and other intangible assets. In accordance with SFAS No. 142, goodwill associated with acquisitions consummated after June 30, 2001 is not amortized. The

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Company implemented the provisions of SFAS No. 142 on November 1, 2001. Since adoption, existing goodwill is no longer amortized but instead will be assessed for impairment at least annually. The adoption of this standard does not have a material impact on the Company's results of operations or financial position.

In July 2001, the FASB issued SFAS No. 144, Impairment or Disposal of Long- Lived Assets, which is effective for fiscal years beginning after December 15, 2001. The provisions of this statement provide a single accounting model for impairment of long-lived assets. The adoption of this standard will not have a material impact on the Company's results of operations or financial position.

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NOTE 5 ACQUISITIONS

Rapid Link, Inc. Acquisition

On October 12, 2001, the Company completed the acquisition of certain assets and liabilities of Rapid Link, USA, Inc. ("Rapid Link USA") and 100% of the common stock of Rapid Link Telecommunications, GMBH ("Rapid Link Germany"), a German Company, from Rapid Link Inc. ("Rapid Link"). The results of the businesses acquired from Rapid Link have been included in operations of the Company in the consolidated financial statements from the date of acquisition. Rapid Link was a provider of high quality integrated data and voice communications services to both wholesale and retail customers around the world. The aggregate purchase price was \$2,116,481, including \$1,450,000 in cash, common stock valued at \$468,000, and an additional \$198,481 in acquisition related costs. The value of the 600,000 common shares was determined based on the closing market price of DTI's common shares on October 12, 2001. The value of the common stock was guaranteed by DTI to be no less than \$300,000 at the time of the effectiveness of the Registration of the shares. As of the effectiveness of the Registration Statement relating to the shares, the value of the common stock was \$210,000. Dial Thru will either (i) issue additional shares to Rapid Link in excess of the 600,000 Shares; or (ii) pay to Rapid Link additional cash consideration, so that the minimum value of the consideration received is \$300,000. Any additional consideration will not change the recorded value of Rapid Link. In accordance with SFAS No. 141 Business Combinations, the Company has allocated the purchase price to net assets acquired, resulting in negative goodwill. Therefore the Company has reduced the net book value of fixed assets by \$1,345,630, the amount representing negative goodwill.

The following unaudited pro-forma consolidated results of operations for the three and six months ended April 30, 2001 assume that the acquisition had occurred on November 1, 2000:

	Three months ended April 30, 2001	Six months ended April 30, 2001
	(Unaudited)	(Unaudited)
Revenues	\$ 7,864,994	\$ 19,054,695
Net loss	\$ (3,144,743)	\$ (3,982,530)
Net loss per common share	\$ (0.28)	\$ (0.37)
Weighted average common shares outstanding (basic and diluted)	11,081,756	10,762,400

NOTE 6 CONVERTIBLE DEBT

Convertible Debentures Issued to Accredited Investors

On February 4, 2000, the Company executed non-interest bearing convertible note agreements (the "Notes") with nine accredited investors, which provided financing of \$1,000,000. The notes were payable on the earlier of one year from the date of issuance or the Company's consummation of a debt or equity financing in excess of \$5,000,000, and to be converted into common stock at a rate of \$4.00 per share if the notes were not repaid within 90 days from the date of issuance. The Company recorded financing fees of approximately \$117,000 in February 2000 related to the Notes for the difference in the conversion price of \$4.00 and the market price of \$4.47 on the date the Notes were approved by the Board of Directors.

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The Company also issued to the holders of the Notes warrants to acquire an aggregate of 125,000 shares of common stock at an exercise price of \$3.00 per share, which expire five years from the date of issuance. In February 2000, the Company recorded a debt discount of approximately \$492,000. This

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amount represents the Company's estimate of the fair value of these warrants at the date of grant using the Black-Scholes pricing model with the following assumptions: applicable risk-free interest rate based on the current treasury-bill interest rate at the grant date of 6%; dividend yields of 0%; volatility factors of the expected market price of the Company's common stock of 1.62; and an expected life of the warrants of three years.

On August 4, 2000, additional warrants to acquire up to an aggregate of 125,000 shares of common stock at an exercise price of \$2.75 per share were issued to the holders of the Notes, as they had not been repaid within six months following the date of issuance. Additional debt discount of approximately \$386,000 was recorded during the fourth quarter of fiscal 2000 related to the issuance of additional warrants. This amount was calculated using the Black-Scholes pricing model with the following assumptions: applicable risk-free interest rate based on the current treasury-bill interest rate at the grant date of 6%; dividend yields of 0%; volatility factors of the expected market price of the Company's common stock of 2.01; and an expected life of the warrants of three years. The Company amortized the total debt discount of approximately \$878,000 over the initial maturity of the Notes of one year.

During March 2001, terms of the Notes were modified and the debt was converted into 400,000 common shares. Additionally, in connection with the conversion, the warrants to purchase 250,000 shares of common stock were modified to allow for an exercise price of \$0.01 per share and 150,000 additional warrants with an exercise price of \$3.00 per share were issued to the note holders. In connection with the grant of the additional 150,000 warrants to the note holders, the Company recorded additional debt discount of approximately \$142,000 which was immediately expensed as the warrants were exercisable at the date of grant, and the note has been redeemed in its entirety. This amount was calculated using the Black-Scholes pricing model with the following assumptions: applicable risk-free interest rate based on the current treasury-bill interest rate at the grant date of 5%; dividend yields of 0%; volatility factors of the expected market price of the Company's common stock of 1.47; and an expected life of the warrants of three years.

Convertible Debentures with Global Capital Funding Group L.P.

On April 11, 2001, the Company executed a 6% convertible debenture (the "Debenture") with Global Capital Funding Group L.P, which provided financing of \$1,000,000. The Debenture maturity date is April 11, 2003. The Debenture is secured by \$320,307 of 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) 80% of the average of the five (5) 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 Debenture shall be at the Formula Conversion Price. The Formula Conversion Price was adjusted downward to 70% in accordance with the terms of the Debenture as the Company's registration statement was not declared effective by the Securities and Exchange Commission on the date required by the Debenture. The Company has calculated the beneficial conversion feature embedded in the Debenture in accordance with EITF No. 00-27 and recorded approximately \$497,000 as a deferred financing fee. This fee is being amortized over the two-year life of the Debenture. During the three and six months ended April 30, 2002, the Company recorded approximately \$69,000 and \$138,000, respectively, as interest expense. The Company also issued to the holder of the debenture warrants to acquire an aggregate of 100,000 shares of common stock at an exercise price of \$0.89 per share, which expire on April 11, 2006. The Company recorded deferred financing fees of approximately \$80,000 relating to the issuance of the warrants. This amount represents the relative fair value of the warrants in accordance with EITF No. 00-27, and the Company is amortizing the fees over the two year life of the Debenture. During the three and six months ended

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April 30 2002, the Company has recorded interest expense of approximately \$10,000 and \$19,000, respectively, relating to the warrants.

On January 28, 2002, the Company executed a 6% convertible debenture (the "Second Debenture") with Global Capital Funding Group L.P, which provided financing of \$550,000. The Second Debenture maturity date is January 28, 2003. The Second Debenture is also secured by \$320,307 of 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 (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 Debenture shall be at the Formula Conversion Price. In connection with the Second Debenture, the Company paid \$92,625 as financing fees, which are being amortized over the one-year life of the Second Debenture using the Interest Method. The Company has calculated the beneficial conversion feature embedded in the Second Debenture in accordance with EITF No. 00-27 and recorded approximately \$114,000 as a deferred financing fee. This fee is being amortized over the one-year life of the Second Debenture. During the three and six months ended April 30, 2002, the Company recorded approximately \$28,000 and \$29,000, respectively, as interest expense. 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 \$0.40 per share, which expire on January 28, 2007. The Company recorded deferred financing fees of approximately \$17,000 related to the issuance of the warrants. This amount represents the relative fair value of the warrants in accordance with EITF No. 00-27, and the Company is amortizing the fees over the one-year life of the Second Debenture. For the three and six months ended April 30, 2002, the Company has recorded interest expense of approximately \$4,000 relating to the warrants.

NOTE 7 NOTES PAYABLE RELATED PARTY

In October 2001, the Company executed 10% convertible notes (the "Notes") with three executives of the Company, which provided financing of \$1,945,958. The maturity date of each note is October 24, 2003. The Notes are secured by all Company assets. Each Note is convertible into the Company's common stock at the option of the holder at each of the six, twelve, eighteen and twenty-four month anniversary of the date of issuance of the note. 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 will be 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 recorded during the fourth quarter of fiscal 2001. The Company determined the additional debt discount by allocating the relative fair value to the Note and the warrants. The Company is amortizing the additional debt discount over the initial maturity of the Note of two years. For the three and six months ended April 30, 2002, the Company has recorded approximately \$102,000 and \$205,000, respectively, of interest expense. In January 2002, an additional \$102,433 was added to the Notes. The Company also issued to the holders of the Notes warrants to acquire an additional 102,433 shares of common stock at an exercise price of \$0.40, which expire on January 28, 2007. Additional debt discount 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. For the three and six months ended April 30, 2002, the Company has recorded approximately \$3,000 of interest expense relating to the warrants.

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NOTE 8 SHAREHOLDERS' EQUITY

COMMON STOCK ISSUANCES

During the six months ended April 30, 2002, the holder of the Company's Debenture converted \$370,000 of debt into approximately 1,420,000 shares of the Company's common stock.

For the six month period ended April 30, 2002, the Company issued 175,000 shares in connection with the exercise of options. The exercise price was paid with 100,000 shares of common stock, which were subsequently retired.

In November 2001, the Company issued 25,000 shares of common stock at no cost for investor relations services.

NOTE 9 SETTLEMENT OF LEGAL/CARRIER DISPUTES

During the quarter ended January 31, 2001, the Company settled a pending lawsuit with Star Telecommunications, Inc. In conjunction with the settlement the Company received a carrier usage credit in the amount of \$780,000 for previous services and future services comprised of one year of no charge domestic carrier services for transporting traffic between Los Angeles, New York and Miami. The Company also received 1,100,000 shares of common stock of Star Telecommunications that were recorded at fair value totaling \$446,820. The Company has recorded the carrier usage credit and the fair value of the shares received as other income and expense in its first Quarter 2001 financial statements.

In the quarter ended January 31, 2001 financial statements, the Company also recorded income of \$465,000 in connection with the settlement of disputes with RSL Communications, Inc. ("RSL"). This amount was originally credited to the Company by RSL during the year ended October 31, 2000. Subsequently, the credit was rescinded and as the outcome was unclear no benefit was recorded during fiscal 2000. During the first quarter of 2001, RSL management acknowledged the credit. The vendor is in the process of liquidating its United States operations. Accordingly, the Company has applied the credit to amounts owed to the vendor and recorded the effect as income in other income

and expense in its 2001 financial statements.

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

FORWARD-LOOKING STATEMENT

This quarterly report on Form 10-Q (this "Report") includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements are statements other than historical information or statements of current condition. Some forward-looking statements may be identified by the use of such terms as "expects", "will", "anticipates", "estimates", "believes", "plans" and words of similar meaning. These forward-looking statements relate to business plans, programs, trends, results of future operations, satisfaction of future cash requirements, funding of future growth, acquisition plans and other matters. In light of the risks and uncertainties inherent in all such projected matters, the inclusion of forward-looking statements in this Form 10-Q should not be regarded as a representation by us or any other person that our objectives or plans will be achieved or that our operating expectations will be realized. Revenues and results of operations are difficult to forecast and could differ materially from those projected in forward-looking statements contained herein, including without limitation statements regarding our belief of the sufficiency of capital resources and our ability to compete in the telecommunications industry. Actual results could differ from those projected in any forward-looking statements for, among others, the following reasons: (a) increased competition from existing and new competitors using voice over Internet protocol ("VoIP") to provide telecommunications services over the Internet, (b) the relatively low barriers to entry for start-up companies using VoIP to provide telecommunications services over the Internet, (c) the price-sensitive nature of consumer demand, (d) the relative lack of customer loyalty to any particular provider of services over the Internet, (e) our dependence upon favorable pricing from our suppliers to compete in the telecommunications industry, (f) increased consolidation in the telecommunications industry, which may result in larger competitors being able to compete more effectively, (g) failure to attract or retain key employees, (h) continuing changes in governmental regulations affecting the telecommunications industry and the Internet and (i) changing consumer demand, technological developments and industry standards that characterize the industry. We do not undertake to update any forward-looking statements contained herein. Readers are cautioned not to place undue reliance on the forward-looking statements made in, or incorporated by reference into, this Report or in any document or statement referring to this Report.

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; providing connectivity to international markets experiencing significant demand for VoIP and other IP enabled services and then targeting the corresponding ethnic segment in the U.S. This change in focus has led to a shift from our prepaid long distance operations toward higher margin international opportunities. This strategy allows us to form local partnerships with foreign PTT's (entities responsible for providing telecommunications services in foreign markets, usually government owned or controlled) and Internet Service Providers ("ISP's"), and to provide IP enabled services based on the in-country regulatory environment affecting telecommunications and data providers. Through these relationships, we are able to acquire a direct equity interest or partnership/joint venture interest in the local business and expect our interest to increase as foreign ownership regulations of telecommunications companies diminish. As an early market entrant building "super-regional" networks, we believe that we are positioned for long-term growth and the provision of high margin, value-added services.

In the third quarter of fiscal 2000, we further concentrated our efforts toward our global VoIP telecommunications strategy by completing the consolidation of our Dallas, Texas and Los Angeles,

California operations into a single facility in Los Angeles, which also houses two sets of our telecommunications switching equipment and enhanced services platforms. Significant reductions in cost have resulted from combining operational organizations. Costs incurred to accomplish this include the relocation of office facilities and staff, as well as costs associated with reduction of personnel resulting from redundancies. Defocusing on the prepaid market caused us to incur other costs associated with the closure of certain distribution channels, and also resulted in a reduction of revenues. The reduction of revenues, however, came from the low or negative margin portion of the prepaid business. 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.

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On October 12, 2001, we completed the acquisition from Rapid Link of certain assets and executory contracts of Rapid Link, USA, Inc. ("Rapid Link USA") and 100% of the common stock of Rapid Link Telecommunications, GMBH ("Rapid Link Germany"), a German Company. Rapid Link is a leading provider of high quality integrated data and voice communications services to both wholesale and retail customers around the world.

CRITICAL ACCOUNTING POLICIES

The consolidated financial statements include accounts of the company and all 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 financial statements, we have made our best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. We do not believe there is a great likelihood that materially different amounts would be reported related to the accounting policies described below. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, 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 to medium sized businesses 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 (SAB) 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 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.

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Goodwill, Intangible and Other Long-Lived Assets

Property, plant and equipment, goodwill, intangible and certain 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. 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

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

RESULTS OF OPERATIONS Three months ended April 30, 2002 compared to the three months ended April 30, 2001

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 small and medium sized enterprises ("SME's"). We charge our customers a fee per minute of usage that are dependent on the destination of the call and is recognized in the period in which the call is completed.

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For the three months ended April 30, 2002, we had revenues of \$6,086,000, an increase of \$5,182,000, or 573%, over the same period in 2001. Revenues for the three months ended April 30, 2002 include \$5,191,000 resulting from the purchase of Rapid Link. For the three months ended April 30, 2002, 57% and 43% of our revenues were derived from our retail and wholesale customers, respectively, compared to 78% and 22%, respectively, for the three months ended April 30, 2001. The overall growth in revenues and the increase in our wholesale revenues is attributable to the acquisition of Rapid Link, as well as a growth in our customer base and the minutes carried across our network.

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OPERATING EXPENSES

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.

For the three months ended April 30, 2002, we had total direct costs of revenues of \$4,251,000, an increase of \$3,642,000, or 598%, over the same period in 2001. Costs of revenues have increased due to the growth in minutes and customers as well as the increased revenue and traffic acquired from Rapid Link. As a percentage of revenues, costs of revenues were 70% of revenues for the three months ended April 30, 2002 compared to 67% of revenues for the three months ended April 30, 2001. Our costs of revenues as a percentage of revenues has increased as a higher percentage of our traffic is attributable to our wholesale business. We continue to focus our efforts on increasing both our retail and wholesale revenues, and anticipate that our margin will fluctuate quarterly depending on the traffic mix.

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.

General and administrative expenses were \$1,973,000 and \$598,000 for the three months ended April 30, 2002 and April 30, 2001, respectively. This increase of \$1,375,000, or 230% includes \$1,072,000 attributable to Rapid Link operations. As a percentage of revenues, general and administrative expenses were 32% and 66% of revenues for the three months ended April 30, 2002 and 2001, respectively. Included in general and administrative expenses is bad debt expense of \$94,000 and \$0 for the three months ended April 30, 2002 and 2001, respectively. We review our general and administrative expenses regularly, and continue to reduce costs as appropriate to support the current business as well as anticipated near term growth.

Sales and marketing expenses include expenses relating to the salaries, payroll taxes, benefits and commissions that we pay for sales personnel and the expenses associated with advertising and marketing programs, including expenses relating to our outside public relations firms.

Sales and marketing expenses were \$339,000, or 6% of revenues for the three months ended April 30, 2002 compared to \$223,000, or 25% of revenues, for the same period last year. Included in sales and marketing expenses for 2002 is \$259,000 attributable to Rapid Link operations. 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. Since we have been successful in growing our revenue base while maintaining a small in-house sales organization, sales and marketing expenses have decreased as a percentage of revenues. We will continue to focus our sales and marketing efforts on newspaper and periodical advertising and agent related expenses to generate additional revenues.

Depreciation and amortization expenses increased to \$616,000 from \$156,000 for the three months ended April 30, 2002 and 2001, respectively. The increase primarily relates to the depreciation and amortization of the assets of the business acquired from Rapid Link. A majority of our depreciation and amortization expense relates to the equipment utilized in our VoIP network, which requires the deployment of sophisticated routers and gateways strategically placed in our Points of Presence and vendor sights around the world.

Interest expense and financing costs are primarily attributable to the amortization of deferred financing fees relating to our various debt instruments. For the three months ended April 30, 2002, the amortization of deferred financing fees relating to our convertible debentures with Global Capital and our related party note payable was \$313,000. For the three months ended April 30, 2001, \$159,000 of

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interest expense and financing fees were primarily attributable to the fair value of warrants issued to the holder of the Company's Convertible Notes which were fully vested at the time of issuance.

During the quarter ended April 30, 2001, the Company recorded a charge of \$435,000 in connection with the decline in fair value of marketable securities previously recorded in a settlement transaction with Star Telecommunications.

As a result of the foregoing, we incurred a net loss of \$1,214,000, or \$0.09 per share, for the three months ended April 30, 2002, compared with a net loss of \$1,193,000 or \$0.11 per share, for the three months ended April 30, 2001.

RESULTS OF OPERATIONS Six months ended April 30, 2002 compared to the six months ended April 30, 2001

REVENUES

For the six months ended April 30, 2002, we had revenues of \$12,673,000, an increase of \$10,879,000, or 606%, over the same period in 2001. Revenues for the six months ended April 30, 2002 include \$10,185,000 resulting from the purchase of Rapid Link. For the six months ended April 30, 2002, 61% and 39% of our revenues were derived from our retail and wholesale customers, respectively, compared to 76% and 24%, respectively, for the six months ended April 30, 2001. The overall growth in revenues and the increase in wholesale revenues is attributable to the acquisition of Rapid Link, as well as a growth in our customer base and the minutes carried across our network.

OPERATING EXPENSES

For the six months ended April 30, 2002, we had total direct costs of revenues of \$8,796,000, an increase of \$7,520,000, or 589%, over the same period in 2001. Costs of revenues have increased due to the growth in minutes and customers as well as the increased revenue and traffic acquired from Rapid Link. As a percentage of revenues, costs of revenue were 69% of revenues for the six months ended April 30, 2002 compared to 71% of revenues for the six months ended April 30, 2001. Although there is a higher percentage of lower margin wholesale traffic for the six months ended April 30, 2002 compared to April 30, 2001, the margin increase from the retail customer base acquired from Rapid Link has offset the increased wholesale traffic, resulting in an overall reduction in our cost of revenues as a percentage of revenues. This percentage will fluctuate quarterly depending on the mix of traffic going forward.

General and administrative expenses were \$3,973,000 and \$1,212,000 for the six months ended April 30, 2002 and April 30, 2001, respectively. This increase of \$2,761,000, or 228% includes \$2,149,000 attributable to Rapid Link operations. As a percentage of revenues, general and administrative expenses were 31% and 68% of revenues for the six months ended April 30, 2002 and 2001, respectively. Included in general and administrative expenses is bad debt expense of \$414,000 and \$0 for the six months ended April 30, 2002 and 2001, respectively. For the six months ended April 30, 2002, the bad debt expense is primarily attributable to non-payment from one wholesale customer. We review our general and administrative expenses regularly, and continue to reduce costs as appropriate to support the current business as well as anticipated near term growth.

Sales and marketing expenses were \$705,000, or 6% of revenues for the six months ended April 30, 2002 compared to \$426,000, or 24% of revenues, for the same period last year. Included in sales and marketing expenses for 2002 is \$499,000 attributable to Rapid Link operations. 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. Since we have been successful in growing our revenue base while maintaining a small in-house sales organization, sales and marketing

expenses have decreased as a percentage of revenues. We will continue to focus our sales and marketing efforts on newspaper and periodical advertising and agent related expenses to generate additional revenues.

Depreciation and amortization expenses increased to \$1,293,000 from \$303,000 for the six months ended April 30, 2002 and 2001, respectively. The increase primarily relates to the depreciation and amortization of the assets of the business acquired from Rapid Link. A majority of our depreciation and amortization expense relates to the equipment utilized in our VoIP network, which requires the deployment of sophisticated routers and gateways strategically placed in our Points of Presence and vendor sights around the world.

Interest expense and financing costs are primarily attributable to the amortization of deferred financing fees relating to our various debt instruments. For the six months ended April 30, 2002, the amortization of deferred financing fees relating to our convertible debentures with Global Capital and our related party note payable was \$582,000. For the six months ended April 30, 2001, \$475,000 of interest expense and financing fees were primarily attributable to amortization of deferred financing fees associated with our convertible notes which were converted

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to equity in March 2001, and the fair value of additional warrants issued to the holders of the notes which were fully vested at the time of issuance.

Settlements with two major carriers over charges in prior periods amounted to a total credit to the statements of operations of \$1,700,000 for the six months ended April 30, 2001. Of this amount, \$780,000 is the result of a settlement with Star Telecommunications ("Star"). Also included is \$446,820 representing common stock received from Star in connection with our dispute settlement. During the six months ended April 30, 2001, the Company recorded a charge of \$435,000 in connection with the decline in fair value of the marketable securities previously recorded in the settlement transaction with Star Telecommunications.

As a result of the foregoing, we incurred a net loss \$2,500,000, or \$0.19 per share, for the six months ended April 30, 2002, compared with a net loss of \$818,000 or \$0.08 per share, for the six months ended April 30, 2001.

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 April 30, 2002, we had cash and cash equivalents of approximately \$487,000, an increase of \$392,000 from the balance at October 31, 2001. As of April 30, 2002, we had a working capital deficit of approximately \$7,118,000, compared to a working capital deficit of approximately \$6,626,000 at October 31, 2001. As of April 30, 2002, our current assets of approximately \$2,847,000 included net accounts receivable of approximately \$1,928,000, which has increased slightly over the balance of \$1,833,000 at October 31, 2001 as a result of revenue growth.

Net cash used in operating activities was \$1,117,000 for the six months ended April 30, 2002, compared to \$909,000 for the six months ended April 30, 2001. The net cash used in operating activities for the six months ended April 30, 2002 was primarily due to a net loss of \$2,500,000 adjusted for: bad debt expense of \$414,000; non-cash interest expense of \$423,000; depreciation and

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amortization of \$1,293,000; and net changes in operating assets and liabilities of (\$752,000). For the six months ended April 30, 2001, the net cash used in operating activities was comprised of a net loss of \$818,000 adjusted for: depreciation and amortization of \$303,000; stock and warrants issued for services of \$259,000; non-cash interest expense of \$475,000; marketable securities and vendor credits received in settlement of disputes of (\$1,789,373); write off of marketable securities received in settlement of disputes of \$436,000 and net changes in operating assets and liabilities of \$226,000.

During the six months ended April 30, 2002, net cash provided by investing activities was \$1,282,000, compared to net cash used in financing activities of \$21,000 for the six months ended April 30, 2001. The net cash provided by investing activities for the six months ended April 30, 2002 is primarily attributable to a refund of a license fee previously paid on behalf of our German subsidiary of \$1,425,000. Investing activities also include capital expenditures of \$143,000 and \$21,000 for the six months ending April 30, 2002 and April 30, 2001, respectively.

Net cash provided by financing activities for the six months ended April 30, 2002, totaled \$227,000, compared to net cash provided by financing activities of \$1,421,000 for the six months ended April 30, 2001. For the six months ended April 30, 2002, significant components of net cash provided by financing activities include \$457,000 in net proceeds from a convertible debenture offset by \$218,000 in payment on capital leases. For the six months ended April 30, 2001, the significant components of net cash provided by financing activities include \$1,000,000 in proceeds from the issuance of our Convertible Debentures, and net proceeds from shareholder of \$410,000.

We are subject to various risks in connection with the operation of our 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, and (vi) our lack of liquidity and our ability to raise additional capital. We have an accumulated deficit of approximately \$38.4 million as of April 30, 2002, as well as a working capital deficit of approximately \$7.0 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:

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- 1) we obtained additional financing of \$550,000 in January 2002. We are currently in negotiations to obtain an additional \$500,000 in financing.
- 2) we have successfully negotiated payment terms on \$1.5 million of our past due trade payables with two of our largest vendors, and we have agreed to remit equal monthly installments in excess of our normal monthly usage billing.
- 3) our trade accounts payable and carrier costs include disputes with certain vendors over what we believe are improper charges primarily for termination of our domestic and international minutes. This amount is approximately \$750,000 at April 30, 2002. We received approximately \$1,400,000 of such credits in fiscal 2001.
- 4) our German subsidiary received a net \$1 million refund for a license fee previously paid, which was used to pay down past due liabilities.

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 the Company's ability to continue as a going concern.

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It is anticipated that general and administrative expenses will continue to increase in absolute dollars, but decline as a percentage of revenues as revenues grow.

Our current capital expenditure requirements are not significant, primarily due to the equipment acquired from Rapid Link. Our capital expenditures for the six months ended April 30, 2002 were \$143,000 and we do not anticipate significant spending for the remainder of fiscal 2002.

On April 11, 2001, we executed a 6% convertible debenture (the "Debenture") with Global Capital Funding Group L.P, which provided financing of \$1,000,000. The Debenture maturity date is April 11, 2003. The conversion price equals 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) 70% of the average of the five (5) lowest volume weighted average sales prices as reported by Bloomberg L.P. during the twenty (20) Trading Days immediately proceeding 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 October 2001, we executed 10% convertible notes (the "Notes") with three of our executives, which provided financing of \$1,945,958. The Notes mature October 24, 2003. The Notes are secured by all Company assets and are convertible into our common stock at the option of the holder at each of the six, twelve, eighteen and twenty-four month anniversary of the date of issuance of the note. 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. An additional 102,433 warrants to acquire our common stock were issued at an exercise price of \$0.40.

On January 28, 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 maturity date is January 28, 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 Debenture shall be at the Formula Conversion Price.

Acquisitions

We continue to review an acquisition strategy within our Telecommunications Business. From time to time we will review acquisition candidates with products, technologies or other services that could enhance our offerings or services. Any material acquisitions could result in us issuing or selling additional debt or equity securities, or obtaining additional debt or other lines of credit and may result in a decrease of our working capital depending on the amount, timing and nature of the consideration to be paid. We are not currently a party to any agreements, negotiations or understandings regarding any material acquisitions.

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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PART II. OTHER INFORMATION

The information in Items 1 through 9 are not applicable to the Company and are, therefore, not included.

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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 Officer)*

Dated June 14, 2002

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QuickLinks

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (Unaudited)

DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENT OF OPERATIONS (Unaudited)

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

DIAL THRU INTERNATIONAL CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

PART II. OTHER INFORMATION

SIGNATURES