ALTERNATIVE TECHNOLOGY RESOURCES INC
Form 10-Q
February 09, 2004

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

Form 10-Q

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2003

Commission file number 0-20468

ALTERNATIVE TECHNOLOGY RESOURCES, INC.
(Exact name of registrant as specified in its charter)

Delaware	68-0195770
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

629 J Street, Sacramento, CA 95814
(Address of principal executive offices)

(916) 231-0400
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

Number of shares of common stock outstanding as of October 31, 2003, 72,476,014

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ALTERNATIVE TECHNOLOGY RESOURCES, INC.
Condensed Balance Sheets
(Unaudited)

Assets	Septemb 200
Current assets:	
Cash and cash equivalents	$ 66
Trade accounts receivable	2
Prepaid expenses and other current assets	11
Total current assets	80
Property and equipment:	
Equipment and software	78
Accumulated depreciation and amortization	(58
Property and equipment, net	20
Prepaid license and service fees	12
	$ 1,13
Liabilities and Stockholders' Equity (Deficit)	
Current liabilities:	
Payable to Healthcare Exchange participants	$ 7
Trade accounts payable	57
Accrued payroll and related expenses	13
Accrued preferred stock dividends	
Accounts payable and accrued interest payable to stockholders	
Notes payable to stockholder	
Convertible notes payable to stockholder	33
Accrued interest payable to third party	1
Other current liabilities	28
Total current liabilities	1,43
Convertible notes payable to third party	1,00
Commitments and contingencies	
Stockholders' equity (deficit):	
Convertible preferred stock, $6.00 par value - 1,200,000 shares authorized none issued and outstanding at September 30, 2003 and June 30, 2003, 204,167 shares designated Series D, none issued and outstanding at September 30, 2003 and June 30, 2003 2,000 shares designated Series A, 1,232 shares issued and outstanding at September 30, 2003 and none issued and outstanding June 30, 2003	
Common stock, $0.01 par value - 100,000,000 shares authorized; 72,476,014issued and outstanding at September 30, 2003 (66,908,669 at June 30, 2003)	72
Additional paid-in capital	65,91
Accumulated deficit	(67,93

Total stockholders' equity (deficit)	(1,29
	$1,13

See accompanying notes to condensed financial statements.

ALTERNATIVE TECHNOLOGY RESOURCES, INC.
Condensed Statements of Operations
(Unaudited)

	Three Mo Septe
	2003
Healthcare exchange	
Revenue	$ 380,817
Costs	(339,753)
Gross profit (loss)	41,064
Selling, marketing and product development costs	(234,840)
General and administrative expenses	(515,252)
Loss from operations	(709,028)
Other income (expense)	
Interest income	250
Interest expense to third party	(103,070)
Interest expense to stockholders and directors	(99,712)
Total other income (expense)	(202,532)
Net loss	$ (911,560)
Basic and diluted net loss per share	$ (0.01)
Shares used in per share calculations	68,595,826

See accompanying notes to condensed financial statements.

ALTERNATIVE TECHNOLOGY RESOURCES, INC.
Condensed Statements of Cash Flows
(Unaudited)

	Three Mont Septembe 2003
Net cash used in operating activities	$ (934,391)
Cash flows used in investing activities:	
Purchases of property and equipment	-
Sale and disposal of property and equipment	76,844
Net cash provided (used) by investing activities	76,844
Cash flows from financing activities:	
Prepaid financing costs	-
Proceeds from sale of preferred stock	1,232,000
Proceeds from exercise of options and warrants	19,559
Proceeds from notes payable to stockholders	-
Proceeds from convertible notes payable to third party and warrants	-
Net cash provided by financing activities	1,251,559
Net increase (decrease) in cash and cash equivalents	394,012
Cash and cash equivalents at beginning of period	270,102
Cash and cash equivalents at end of period	$ 664,114

See accompanying notes to condensed financial statements.

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ALTERNATIVE TECHNOLOGY RESOURCES, INC.
Notes to Condensed Financial Statements
September 30, 2003
(Unaudited)

Note 1 - Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Alternative Technology Resources, Inc.'s (hereinafter referred to as "ATR", the "Company, " "we," or "us") annual report on Form 10-K for the fiscal year ended June 30, 2003. On November 12, 2003, the Company and its independent auditors, Ernst & Young LLP, mutually agreed to cease their existing professional relationship. This change has been reported in a Form 8-K dated November 12, 2003. The Company is currently involved in the process of engaging a new independent public accountant. As a result, the interim financial statements included in this quarterly report on Form 10-Q were not reviewed by an independent public accountant.

In the opinion of management, the unaudited condensed financial statements contain all adjustments, consisting of normal recurring adjustments, considered necessary to present fairly the Company's financial position at September 30, 2003 and June 30, 2003, results of operations for the three months ended September 30, 2003 and 2002, and cash flows for the three months ended September 30, 2003 and 2002. The results for the period ended September 30, 2003 are not necessarily indicative of the results to be expected for the entire fiscal year ending June 30, 2004.

The Company has incurred operating losses since inception, which have resulted in an accumulated deficit of $67,939,620 at September 30, 2003. As we enter fiscal year 2004, we continue to face significant challenges with respect to revenue and cash shortages. In light of our prior losses and current stock price of our common stock, no assurance can be given that we will be able to raise additional funds for our operations, if necessary. We are taking a number of steps to address these challenges including further reductions in operating expenses and liabilities. In addition, our business strategy is to transition our existing Providers to our direct pay program where Providers will submit their claims to us, and we will process and reprice the claims to the rate set by Providers. After re-pricing, claims will be then sent to Purchasers or their intermediaries who will pay the Providers directly. Providers will be invoiced our transaction fee for each claim re-priced. We will recognize revenue when it is earned and collectibility is reasonably assured. Revenue is earned when we have completed claim re-pricing obligations under our service agreement with the Provider.

We launched our direct pay program during quarter ending September 30, 2003. Under this program, we will receive a fee for each claim that we process. In order to attract new Providers and increase the number of claims that we

process, we have reduced our transaction fee which will require us to process a higher number of claims that we have not previously been able to obtain in order to generate sufficient revenue for our operations. This program is new and we are unsure whether it will be accepted by the healthcare industry or whether we will be able to attract sufficient number of Providers in order to process the number of claims we will need to generate sufficient revenues to sustain our operations. If we are unable to successfully launch our direct pay program or gain the confidence of Providers, we may be required to further reduce our operation expenses or be forced into seeking protection under federal bankruptcy laws.

Note 2 - Financing Arrangements

On August 15, 2003, Mr. James W. Cameron, the Company's former officer and director, purchased 1,232 shares of our Series A Preferred Stock, $6.00 par value per share, at $1,000 per share for an aggregate sum of $1,232,000. The Series A Preferred Stock provides for a dividend preference of $0.50 per share if and when declared by the board of directors and a liquidation preference of $6.00 per share. In addition, the shares of Series A Preferred Stock have no voting rights, except as required by law, and are not convertible into any other securities.

On August 15, 2003, Mr. Cameron assigned to Mr. Baron, our new chairman, all of his interest to the promissory notes payable by the Company in the aggregate principal amount of $2,873,694 along with $283,195 in accrued Series D Preferred Stock dividends owed by the Company. On September 18, 2003, Mr. Baron forgave all of the obligations owed by the Company under the promissory notes including the accrued and unpaid interest along with $283,195 in accrued Series D Preferred Stock dividends.

On August 15, 2003, Mr. Cameron, McCormick ATEK Investments LLC, an entity controlled by Mr. Jeffrey McCormick, our director and former officer, and the Company mutually agreed, without value, to cancel the option requiring Mr. Cameron to sell 6,000,000 shares of our common stock owned by Mr. Cameron to McCormick ATEK Investment LLC at the purchase price of $3.625 per share.

On September 19, 2003, we reached an agreement with The Negri Trust to convert $2,344,704 of the outstanding principal and all accrued and unpaid interest as of that date under convertible notes into 3,086,043 shares of our common stock.

During fiscal year 2003, the facilities lease agreement between the Company and the Mr. James W. Cameron was modified to reflect an annual base rent of $120 until further notice from lessor, in his sole and absolute discretion, to return the rent to its previous level. To recognize the estimated market rate of this transaction, a monthly expense of $11,424 was recognized through rent expense and other capital contributions. On July 1, 2003, Company entered into a sixth addendum to the lease, which reduces the square footage occupied by the Company and stipulates the monthly rent to be $3,794.

On July 26, 2002, the Company received short-term unsecured financing in the form of a convertible note of $1,000,000 from a lender ("Convertible Note").

This Convertible Note, bearing interest at 8% was originally payable on July 25, 2003. On July 25, 2003, the Company extended this note to the earlier of July 22, 2005 or when the Company receives $8,000,000 in debt or equity financing. All or a portion of the convertible note may be converted into shares of common stock at the lower of $ 1.00 per share or the subsequent subscription price per share of any debt or equity offering made by the Company. In consideration for the amendment, the Company agreed to convert all accrued and unpaid interest as of July 25, 2003 into 2,285,714 shares of its common stock at a rate of $0.035 per share and to secure the Convertible Note with our assets. In connection with the amendment, the Company has classified the Convertible Note as a long-term obligation since the term of repayment has been extended to July 22, 2005.

In consideration for the Convertible Note, the Company issued three warrants on July 26, 2002. Each warrant provides for the purchase of 100,000 shares of the Company's common stock at an exercise price equal to the $1.00 subscription per share price of the Company's October 2002 Private Placement. The First and

Second Warrants became exercisable on July 26, 2002 and January 26, 2003, respectively, and are exercisable before the expiration date. The Third Warrant issued became exercisable on July 26, 2003 and is also exercisable before the expiration date. When, and if, exercisable the lender may exercise these warrants through July 26, 2009.

In connection with the issuance of the Note and the First and Second Warrants, the Company estimated the aggregate fair value of the First and Second Warrants to be $254,000 using the Black-Scholes model. In accordance with EITF 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," and EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," the Company has recognized $952,930 through interest expense for fiscal year 2003 for a portion of the fair value of the First and Second Warrants and a portion of the beneficial conversion feature of the Note, which was estimated to be in total $802,000. The Company recorded additional amounts totaling $103,070 in the quarter ending September 30, 2004 through interest expense for the remaining fair value of the First and Second Warrants and the beneficial conversion feature of the Note recorded at the initial transaction date, and in accordance with EITF 00-27, the additional beneficial conversion feature recorded in the quarter ending December 31, 2002 of $624,222 relating to the reset of the conversion price of the Note from $2.25 to $1.00 per share.

In July 2002, the Company engaged a placement agent to assist in the sale of shares of the Company's common stock in a private placement. During October 2002, the Company received gross proceeds of $4,125,000 through the sale of 4,125,000 shares pursuant to this offering. Cash proceeds net of offering costs were $3,816,209. In connection with the October 2002 Private Placement, the Company paid the placement agent a placement fee of 6% of the gross proceeds raised by them and a five year warrant to purchase 10% of the common stock placed by them at an exercise price of $1.00 per share. In addition, the Company paid a finder's fee to one individual of $12,500 and issued a warrant to purchase 30,000 shares of common stock at $1.00 per share. The warrant had an estimated fair value of $22,800.

Resulting from the closing of the October 2002 Private Placement, 1,540,729 additional shares were issued to investors who purchased shares of common stock

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in the January 2002 Private Placement based on the October 2002 Private Placement price of $1.00 per share. Compensation expense of $347,222 was recorded for the additional shares issued to the Company's then Chairman and Chief Financial Officer.

As a result of the issuance of the Convertible Note on July 26, 2002 in which the Company granted warrants equal to 30% of the loan at an exercise price of $1.00 per share, the Company granted to the investors of the January 2002 and October 2002 Private Placements warrants to purchase 30% of their respective investment at an exercise price of $1.00 per share. Mr. Cameron, as a participant in the private placement, received a warrant to purchase 150,000 shares of common stock at an exercise price of $1.00 per share, which was greater than the fair value of the common stock at the warrant issuance date.

As of quarter ending September 30, 2003, the amount of $336,711 is outstanding under an unsecured convertible note from a shareholder of the Company. This note bears interest at 10.25% per annum and is due on December 31, 2003.

Note 3 - Comprehensive Loss

Total comprehensive loss for the three months ended September 30, 2003 and 2002 was $911,560, and $1,886,806. Other comprehensive income (loss) represents the net change in unrealized gains (losses) on available-for-sale securities.

Note 4 - Net Loss Per Share

As the Company has reported net losses in all periods presented, basic and diluted loss per share have been calculated on the basis of net loss applicable to common stockholders divided by the weighted average number of common stock shares outstanding without giving effect to outstanding options, warrants, and convertible securities whose effects are anti-dilutive. For the three months ended September 30, 2003 and 2002 there were stock options, stock warrants, and convertible notes payable outstanding, which could potentially dilute earnings per share in the future but were not included in the computation of diluted loss per share as their effect was anti-dilutive in the periods presented.

The Company accounts for its stock-based compensation plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Under the intrinsic value method, compensation cost is the excess, if any, of the quoted market price or fair value of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock.

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provision of Statement of Financial Accounting Standards Board Statement No. 123, "Accounting for Stock-Based-Compensation" to stock-based compensation.

	Three Months Ended September 31,	
	2003	2002
Net loss, as reported	$ (911,560)	$(1,886,806)
Add: Stock-based employee compensation expense included in reported net loss	-	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	-	-
Pro forma net loss	$ (911,560)	$(1,886,806)
Loss per share:		
Basic and diluted - as reported	$ (0.01)	$ (0.03)
Basic and diluted - pro forma	$ (0.01)	$ (0.03)

Option valuation models were developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected life of the option. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimates, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Note 5 - Commitments and Contingencies

The Company may from time to time become a party to various legal proceedings arising in the ordinary course of its business. The Company is not currently subject to any legal proceedings.

The Company signed agreements effective in January 2001 with an application services provider to license, support and run software to process medical claims submitted to the Company's Healthcare Exchange. The agreements are for a period of 66 months. They required payment of an initial base license fee of $250,000, which is being amortized over the expected term of the arrangement, and data center set up, training and implementation fees of about $145,000, which were expensed. The agreements require monthly minimum payments currently of about $35,000 and additional fees that are transaction based if volumes exceed levels included in the monthly minimums. On October 10, 2003, the Company terminated its agreement with the application services provider. As a result, the Company pursued the development of an internal technical solution to replace the services provided by this vendor. The internal application was implemented on October 15, 2003.

In November 1995, the Company entered into a lease agreement for its facility in Sacramento, California under a one-year lease with Mr. Cameron. The lease has been extended to January 31, 2004. Payments under this facilities lease were approximately $141,330 per year. At June 30, 2003, $559,220 of rent owed for fiscal years 1996 through 2003 is included in the balance of accounts payable and accrued interest payable to stockholders. During the fiscal year 2003, the facilities lease agreement between the Company and Mr. Cameron was modified to reflect an annual base rent of $120 until further notice from lessor, in his sole and absolute discretion, to return the rent to its previous level. To recognize the estimated market rate of this transaction, a monthly expense of $11,424 was recognized through rent expense and other capital contributions. On July 1, 2003 the Company entered into a sixth addendum to the lease, which reduces the square footage occupied by the Company and stipulates the monthly rent to be $3,794.

Note 6 - Stock Option Grant

On January 25, 2003, the Board of Directors approved the issuance of a non-qualified option grant to Mr. Jeffrey S. McCormick, Chief Executive Officer, to purchase up to 4,000,000 shares of common stock at the exercise price of $1.25 per share. The effective date of the option grant was November 7, 2002. Subject to acceleration events, the option grant was to vest over a four-year period, commencing with the vesting of the first 1,000,000 shares of common stock on January 31, 2003. No compensation expense was recorded in connection

with this option grant, as the exercise price was greater than the fair value of the common stock at the option grant date. Subsequent to the June 30, 2003, Mr. McCormick's employment agreement was terminated because of his resignation as the Company's Chief Executive Officer. Pursuant to the terms of the option agreement, all 4,000,000 options immediately vested and are exercisable.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion provides information to facilitate the understanding and assessment of significant changes in trends related to the financial condition of the Company and its results of operations. It should be read in conjunction with the Company's financial statements and the notes thereto and other financial information included elsewhere in the Form 10-K for the fiscal year ended June 30, 2003.

OVERVIEW

General

As used in this report, the terms "we," "us," "our", "ATR," and the "Company" mean Alternative Technology Resources, Inc., unless otherwise indicated.

We are engaged in the business of operating a Healthcare Exchange. In July 2003, we began operating the Healthcare Exchange under our new name "National Healthcare Exchange Services" or "NHXS". The purpose of the Healthcare Exchange is to facilitate provider initiated discounts for all commercial lines of business in the healthcare industry. The Healthcare Exchange offers a direct conduit between medical doctors, medical groups, hospitals and other healthcare practitioners (collectively "Providers") and those who purchase or facilitate the purchase of healthcare services and/or their agents, such as Preferred Provider Organizations ("Purchasers"). The Healthcare Exchange is used in the absence of an existing agreement between the Provider and the Purchaser of healthcare services.

Under the Healthcare Exchange program, Providers submit claims to us, and we process and reprice the claims to the rate set by the Providers, including adding a transaction-processing fee. We then route the adjusted claims to Purchasers or their intermediaries. We receive payments from Purchasers on behalf of Providers, and then remit payments to Providers.

During fiscal 2003, we experienced substantial loss in implementing and operating the Healthcare Exchange. As a result, we are revising our Healthcare Exchange program to provide for a direct pay program whereby Providers' claims will be sent to the Purchasers via our Healthcare Exchange and payment will be made directly to the Providers. We will then invoice the Providers a transaction fee for each claim processed and forwarded to the Purchaser.

Our Healthcare Exchange began operations with a limited number of Providers and Purchasers in the quarter ending June 30, 2001. We continue to receive, process, and analyze operating data, and the results of our analysis will determine the amount and timing of remaining development related efforts.

There are no geographic limitations to the recruitment of Providers. However, our primary recruitment efforts have been in 15 states and the District of

Columbia.

We have outsourced to multiple vendors portions of the development and operations of the information systems for the Healthcare Exchange. We work with vendors to receive claims from Providers through electronic clearinghouses and to convert paper claims into electronic formats. We are evaluating other potential technology vendors as well.

We do not provide healthcare services, but rather act as a neutral conduit between Providers and Purchasers including preferred provider organizations. We believe that our Healthcare Exchange provides both economic and administrative efficiencies to both Providers and Purchasers in the absence of a traditional health plan agreement.

History

In August 1999, we identified what we believe to be a significant business opportunity in the healthcare industry and began developing a business model involving the establishment of the Healthcare Exchange under the name "DoctorandPatient." Prior to providing an exchange for healthcare services, we

were in the business of recruiting, hiring and training foreign computer programmers and placing them with U.S. companies. During fiscal year 2001, we ceased our computer programmer operations to concentrate on our Healthcare Exchange and, in July 2003, we began phasing out the name "DoctorandPatient" and began marketing under the new name "National Healthcare Exchange Services."

During fiscal year 2003, we focused our attention on expanding our markets in order to try to increase our revenues. In line with our objectives, we hired a significant number of employees to promote the Healthcare Exchange. This rapid growth in employees placed a significant strain upon our financial resources without producing sufficient revenue to accommodate this growth. As a result, we had to take steps to reduce our expenses in an effort to improve our financial condition. Such steps included closing our headquarters located in Portsmouth, New Hampshire and relocating these functions to our office in Sacramento, California. In addition, we reduced the number of our employees from 98 as of December 31, 2002 to 27 by September 30, 2003.

As we enter fiscal year 2004, we continue to face significant challenges with respect to revenue and cash shortages. As of September 30, 2003, our cash balance had declined to approximately $700,000, and in light of our prior losses and current stock price of our common stock, no assurance can be given that we will be able to raise additional funds for our operations, if necessary. We are taking a number of steps to address these challenges including further reductions in operating expenses and liabilities. In addition, our business strategy is to transition our existing Providers to our direct pay program where Providers will submit their claims to us, and we will process and reprice the claims to the rate set by Providers. After re-pricing, claims will be then sent to Purchasers or their intermediaries who will pay the Providers directly. Providers will be invoiced our transaction fee for each claim re-priced. We will recognize revenue when it is earned and collectibility is reasonably assured. Revenue is earned when we have completed claim re-pricing obligations under our service agreement with the Provider.

During quarter ending September 2003 we launched our direct pay program. Under this program, we receive a fee for each claim that we process. In order to attract new Providers and increase the number of claims that we process, we have reduced our transaction fee which will require us to process a higher number of claims that we have not previously been able to obtain in order to generate

sufficient revenue for our operations. This program is new and we are unsure whether it will be accepted by the healthcare industry or whether we will be able to attract sufficient number of Providers in order to process the number of claims we will need to generate sufficient revenues to sustain our operations. If we are unable to successfully launch our direct pay program or gain the confidence of Providers, we may be required to further reduce our operation expenses or be forced into seeking protection under federal bankruptcy laws.

We believe that the value proposition of the Healthcare Exchange for our direct pay program is significant. The transition to the direct pay program has been driven by the cost and complexity of receiving and processing payments from Purchasers on behalf of Providers. Our current program, whereby we would receive payments directly from the Purchasers and remit the payment, after deducting our fee, to the Providers created a tension between the Provider and us that interfered with efforts by our sales and marketing staff to recruit new Providers. By developing the direct pay program, we removed the Healthcare

Exchange between the Purchaser's payments and the Provider, and allowed the Healthcare Exchange to act as a neutral conduit. We believe that the simplicity of the direct pay program will allow us to accelerate the growth in new Providers. We also believe that the direct pay program will also reduce the barriers to marketing to large healthcare provider organizations. Under the direct pay program, our transaction fee will be less than our transaction fee for our current program. Therefore, we must substantially increase the number of claims that we process in order to generate sufficient revenues for our operations. We intend to initially market our direct pay program to our existing Providers by transitioning them from our current program to the direct pay program. If we are unable to successfully launch our direct pay program or gain the confidence of Providers, we may be required to further reduce our operating expenses and/or seek additional funds for our operations. If we are unable to raise additional funds, we may be forced into seeking protection under federal bankruptcy laws.

In addition to the direct pay program, we will begin test marketing of a compliance program. The compliance program allows the Healthcare Exchange to re-price medical claims within an existing agreement between the Provider and the Purchaser. The compliance program could allow Providers to use the Healthcare Exchange for more of their claims. Our market with the direct pay program is limited to those claims for which there is no existing health plan agreement. Applying the efficiencies of the Healthcare Exchange to an existing health plan agreement can improve the Providers' ability to insure compliance with a health plan's fee schedule. More importantly, we believe that this compliance program could significantly increase the number of claims we process for Providers.

Critical Accounting Policies

REVENUE RECOGNITION. The Company recognizes revenue for the transaction-processing fee when earned and the Company has substantially completed all of its obligations under the contract.

PRODUCT DEVELOPMENT COSTS. In October 1999, the Company began incurring costs to develop its Healthcare Exchange. In accordance with SOP 98-5, "Reporting Costs on Start-Up Activities," start-up costs associated with the Healthcare Exchange have been expensed as incurred.

PREPAID LICENSE AND SERVICE FEES. Prepaid license and services fees are recorded at cost and amortized on a straight-line basis over the service period.

Management considers whether indicators of impairment of these assets are present at each balance sheet date and an impairment loss is recorded, if necessary. In assessing the recoverability of the Company's prepaid license and service fees, the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for these assets not previously recorded.

FINANCIAL CONDITION

Cash and cash equivalents increased $394,012 since June 30, 2003 attributable to cash proceeds from financing activities of $1,232,000received in August 2003

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from the sale of Series A Preferred stock, partially offset by cash used in operations of $934,391 during the three months ended September 30, 2003. At September 30, 2003, substantially all of ATR's cash was invested in money market accounts.

Because the Company is emphasizing the development of the Healthcare Exchange, the results of operation for the three months ended September 30, 2003 may not be indicative of results of operations for the year ended June 30, 2003.

RESULTS OF OPERATION

Healthcare Exchange

HEALTHCARE EXCHANGE REVENUE. The Company began operations with a limited number of Providers in the quarter ending June 30, 2001. Providers submit bills to ATR, who reprices the bills to the rate set by the Providers, including adding a transaction-processing fee, and then routes them to Purchasers or their intermediaries. ATR receives payments from Purchasers on behalf of Providers, and then remits payments to Providers. The Company recognizes revenue for the transaction-processing fee when earned and the Company has substantially completed all of its obligations under the contract. Under the direct pay program providers submit their healthcare claims to us for re-pricing to the Healthcare Exchange rate. We then route the adjusted claims to Purchasers or their intermediaries, who pay the Providers directly. We then invoice the Providers a transaction fee for each claim processed and forwarded to the Purchaser.

During the three month period ending September 30, 2003, $380,817 of revenue was recognized, as compared to $776,560 for the three month period ending September 30, 2002. The development and implementation of the direct pay program and transitioning of our Providers to the direct pay program was the primary cause of the reduction in revenue in comparison to the previous year.

HEALTHCARE EXCHANGE COSTS. Healthcare Exchange costs are the direct costs related to the processing of the bills submitted by Providers and payments received from Purchasers. These costs include the salary and other wage and benefit costs of the Healthcare Exchange operations staff and the operating cost of the application services provider and other technology providers. The costs for the three month period ending September 30, 2003 were $339,753 in comparison to $543,702 for the three month period ending September 30, 2002. The decrease is primarily due to the reduction in staffing and related costs, and other cost reduction measures implemented during the September 2003 quarter end. As of September 30, 2003, there were 10 operations staff members responsible for the processing of bills submitted by Providers and payments received from Purchasers, compared to 31 operations staff members as of September 30, 2002.

Selling, Marketing and Product Development Costs

In October 1999, the Company began incurring costs to develop its Healthcare Exchange. Costs incurred are primarily the salary, other wage and benefit costs of ATR's employees and other operational costs associated with recruiting the network of healthcare providers. The costs for the three month period ending September 30, 2003 were $234,840, in comparison to $1,397,306 for the three

month period ending September 30, 2002. The decrease is the result of reduction of sales staff to 8 at September 30, 2003 from 43 at September 30, 2002. The Company's existing IT staff developed the internal repricing and compliance program, resulting in development costs being recognized as compensation.

General and Administrative Expenses

General and administrative expenses were $515,252 for the three month period ended September 30, 2003, in comparison to $509,015 for the three month period ending September 30, 2002. The increase for the three month period ended September 30, 2003 in comparison to the same period ended September 30, 2002 was the result of the expense of approximately $125,714 recorded during the three month period ended September 30, 2003 for the conversion of interest accrued on the $1,000,000 convertible note payable to common stock at less than market value. This expense was offset by the decrease in compensation and related expenses as a result of reductions in staffing.

Other Income (Expense)

INTEREST INCOME. Interest income is related to the short-term investment of cash balances, primarily in money market accounts. The change in the three month period ending September 30, 2003 is not significant in comparison to the same period in fiscal 2002.

INTEREST EXPENSE TO THIRD PARTY. Interest expense to third party of $103,070, for the three month period ending September, 2003, in comparison to $77,315 for the three month period ending September 30, 2002, resulted primarily from the fair value of warrants issued in connection with a convertible note and the beneficial conversion feature of the convertible note to third party, which were recognized through interest expense

INTEREST EXPENSE TO STOCKHOLDERS AND DIRECTORS. Interest expense to stockholders and directors of $99,712, was recognized for the three month period ending September 30, 2003 in comparison to $136,458, for the three month period ending September 30, 2002. This decrease resulted primarily from the conversion of accrued interest on convertible notes payable to stockholder into common stock and the forgiveness of debt of accrued interest on notes payable to stockholder during the three month period ending September 30, 2003.

Income Taxes

As of June 30, 2003, we had net operating loss carryforwards for federal income tax purposes of approximately $53,000,000 that expire in the years 2005 through 2023 and federal research and development tax credits of approximately $100,000 that expire in the year 2005.

As of June 30, 2003, we had net operating loss carryforwards for state income tax purposes of approximately $20,000,000 that expire in the years 2004 through 2013 and state research and development tax credits of approximately $30,000 that do not expire.

In connection with our initial public offering in August 1992, a change of ownership (as defined in Section 382 of the Internal Revenue Code of 1986, as amended) occurred. As a result, our net operating loss carryforwards generated through August 20, 1992 (approximately $1,900,000) are subject to an annual limitation in the amount of approximately $300,000.

In 1993, a controlling interest of our stock was purchased, resulting in a second annual limitation in the amount of approximately $398,000 on our ability to utilize net operating loss carryforwards generated between August 11, 1992 and September 13, 1993 (approximately $7,700,000).

Utilization of our net operating loss and credit carryforwards may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss and credits before utilization.

We expect that the aforementioned annual limitations will result in net operating loss carryovers, which will not be utilized prior to the expiration of the carryover period.

LIQUIDITY AND CAPITAL RESOURCES

For the three month period ending September 30, 2003, we earned revenues of $380,817 but incurred a net loss of $911,560. In August 2003, we raised additional capital through the sales of 1,232 shares of our Series A Preferred Stock, $6.00 par value per share, at $1,000 per share for an aggregate sum of $1,232,000. It is our intention to use this capital to successfully market and implement the direct pay program to attract new Providers and to increase the number of claims that we process. However, this direct pay program is new and we are unsure whether it will be accepted by the healthcare industry or whether we will be able to attract a sufficient number of Providers in order to process the number of claims we will need to generate sufficient revenues to sustain our operations. In order to attract new Providers and increase the number of claims that we process under this new direct pay program, we have reduced our transaction fee which will require us to process a higher number of claims that we have not previously been able to obtain in order to generate sufficient revenue for our operations. As of September 26, 2003, our cash balance had declined to approximately $700,000. In light of our prior losses and current stock price, it is unlikely that we will be able, at this time, to raise additional capital if required. If our direct pay program is unsuccessful, we will be required to further reduce our expenses. If we are unable to successfully launch our direct pay program or gain the confidence of Providers, we may be required to further reduce our operating expenses and/or be forced into seeking protection under federal bankruptcy laws. Given the conditions described above, the report of independent auditors on our June 30, 2003 financial statements includes an explanatory paragraph indicating there is substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

As of June 30, 2003, we had received short-term, unsecured financing to fund our operations in the form of notes payable of $5,555,109 from Mr. Cameron, our then chairman and chief financial officer and another stockholder. These notes bear

interest at 10.25%. On November 1, 2002, we agreed with Mr. Cameron to extend the due date on notes payable to him until December 31, 2003 in exchange for an extension fee of 2%. These extended notes total $2,873,694, including accrued interest and extension fees, and bear interest at 10.25% per annum. Also on November 1, 2002, we agreed with the other note holder to extend the due date of his convertible promissory notes until December 31, 2003. These convertible promissory notes total $2,681,415, including accrued interest, bear interest at 10.25% per annum and are convertible into common stock at $3.00 per share at the note holder's option. During fiscal year 2003, Mr. Cameron loaned us an additional $619,000 bearing interest at 10.25%, of which $193,000 was repaid to Mr. Cameron in October 2002. During the first quarter of fiscal 2004, the notes payable in the amount of $2,873,694 were assigned by Mr. Cameron to Mr. Baron, and as September 30, 2003, Mr. Baron forgave all of the obligations under such notes. In addition, of the convertible notes totaling $2,681,415, the note holder agreed to convert $2,344,704 of the outstanding principal and all accrued and unpaid interest under certain convertible notes into 3,086,043 shares of our common stock leaving a total of $336,711 outstanding.

In October 2002, we sold 4,125,000 shares of our common stock at a purchase price of $1.00 per share. The shares of common stock issued in the private placement are restricted securities. Cash proceeds, net of offering costs, were $3,816,209. In connection with the October 2002 private placement, we paid the placement agent a placement fee of 6% of the gross proceeds raised by them and a five year warrant to purchase 10% of the common stock placed by them at an exercise price of $1.00 per share. In addition, we paid a finder's fee to one individual of $12,500 and issued a warrant to purchase 30,000 shares of common stock at $1.00 per share.

On July 26, 2002, we received short-term unsecured financing in the form of a convertible note of $1,000,000 from a lender. This convertible note bears interest at 8% and was originally payable on July 25, 2003. On July 25, 2003, we extended this note to the earlier of July 22, 2005 or when we receive $8,000,000 debt or equity financing. All or a portion of the convertible note may be converted into shares of common stock at the lower of $1.00 per share or the subsequent subscription price per share of any debt or equity offering made by us.

In consideration for the loan, we issued three warrants on July 26, 2002. Each warrant provides for the purchase of 100,000 shares of our common stock at an exercise price equal to the $1.00 subscription per share price of the October 2002 private placement. The first and second warrants became exercisable on July 26, 2002 and January 26, 2003, respectively. The third warrant became exercisable on July 25, 2003. The lender may exercise these warrants through July 26, 2009.

In connection with the issuance of the convertible note and the first and second warrants, we estimated the aggregate fair value of the first and second warrants to be $254,000 using the Black-Scholes model. In accordance with EITF 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," and EITF 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," we have recognized $309,211 and $952,930 through interest expense for the three and twelve month periods respectively, ending June 30, 2003 for a portion of the fair value of the first and second warrants and a portion of the beneficial conversion feature of the convertible note, which was estimated to be in total $802,000. We have recorded additional amounts totaling $103,070 during the first quarter of 2004 through

interest expense for the remaining fair value of the first and second warrants and the beneficial conversion feature of the convertible note recorded at the initial transaction date, and in accordance with EITF 00-27, the additional beneficial conversion feature recorded in the quarter ending December 31, 2002 of $624,222 relating to the reset of the conversion price of the convertible note from $2.25 to $1.00 per share.

During the period between January 9, 2002 and March 28, 2002, we sold 1,232,584 shares of our common stock at a purchase price of $2.25 per share. The shares of common stock issued in the private placement are restricted securities. Proceeds, net of offering costs, were $2,742,519. The proceeds from the private placement were used to fund operations and repay debt. Our then chairman and chief financial officer purchased 222,222 shares our common stock in the private placement. Because the purchase price of such stock was less than the public trading price on the date of purchase, we recorded compensation expense of $138,583 during fiscal year 2002. In October 2002, pursuant to the terms of this private placement and as a result of the October 2002 private placement at a purchase price lower than $2.25, 1,540,729 additional shares were issued to these investors based on the October 2002 private placement price of $1.00 per share. Compensation expense of $347,222 was recorded for the additional shares issued to our then chairman and chief financial officer.

As a result of our July 2002 bridge financing in which we granted warrants equal to 30% of the loan at an exercise price of $1.00 per share, we granted to the investors of the January 2002 and October 2002 private placements warrants to purchase 30% of their respective investment at an exercise price of $1.00 per share. Our then chairman and chief financial officer, a participant in the private placement, received a warrant to purchase 150,000 shares of common stock at an exercise price of $1.00 per share, which was greater than the fair value of the common stock at the warrant issuance date.

The following table represents the debt requirements pertaining to contractual obligations of the Company over the next five years:

Contractual Obligations	Payments Due by Period		
	Total	Less than 1 year	1-3 years
Convertible notes payable to stockholder	336,711	336,711	-
Convertible note payable to third party	1,000,000		1,000,000
Operating leases - facilities - payable to stockholder	275,860	34,146	140,722
Operating leases - equipment	52,549	32,190	20,359
Application services provider	33,842	33,842	-
Total contractual cash obligations	$ 1,698,962	$ 436,889	$ 1,161,081

During fiscal year 2003, the facilities lease agreement between the Company and the Mr. James W. Cameron was modified to reflect an annual base rent of $120 until further notice from lessor, in his sole and absolute discretion, to return the rent to its previous level. To recognize the estimated market rate of this transaction, a monthly expense of $11,424 was recognized through rent expense and other capital contributions. On July 1, 2003, Company entered into a sixth addendum to the lease, which reduces the square footage occupied by the Company and stipulates the monthly rent to be $3,794.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company has notes payable in the aggregate amount of $1,336,711 as of September 30, 2003 payable to a stockholder of the Company and another lender. The notes bear interest at 8% to 10.25% per annum and are due from December 31, 2003 to July 22, 2005, or earlier if other funding is obtained. The Company does not believe that any change in interest rates will have a material impact on the Company during fiscal 2004. Further, the Company has no foreign operations and therefore is not subject to foreign currency fluctuations.

Item 4. Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined by Exchange Act Rule 13a-15(e)) as of the end of our first fiscal quarter pursuant to Exchange Act Rule 13a-15(b). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in our internal control over financial reporting identified in connection with our evaluation as of the end of the first fiscal quarter that occurred during such quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, on November 12, 2003, the Company and its independent auditors, Ernst & Young LLP, mutually agreed to cease their existing professional relationship. This change has been reported in a Form 8-K dated November 12, 2003. The Company is currently involved in the process of engaging a new independent public accountant. As a result, the interim financial statements included in this quarterly report on Form 10-Q were not reviewed by an independent public accountant.

PART II. OTHER INFORMATION

Item 1 Legal Proceedings

None

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Item 2 Changes in Securities and Use of Proceeds

On July 25, 2003, we issued 2,285,714 shares of our common stock to a lender for all accrued and unpaid interest in the aggregate amount of $80,000 under a convertible note as of July 25, 2003. The issuance was exempt from registration pursuant to Rule 506.

On August 15, 2003, we sold 1,232 shares of our Series A Preferred Stock, $6.00 par value per share, at $1,000 per share for an aggregate sum of $1,232,000 to an accredited investor pursuant to Rule 506. No commission or finder's fee was paid in connection with this transaction. The Series A Preferred Stock provides for a dividend preference of $0.50 per share if and when declared by the board of directors and a liquidation preference of $6.00 per share. In addition, the shares of Series A Preferred Stock have no voting rights, except as required by law, and are not convertible into any other securities.

On September 19, 2003, we reached an agreement with The Negri Trust to convert $2,344,704 of the outstanding principal and all accrued and unpaid interest as of that date under the convertible notes into 3,086,043 shares of our common stock. The issuance was exempt from registration pursuant to Rule 506. We amended the original convertible notes to provide for the issuance of shares for accrued and unpaid interest. Further, under the terms of this amendment, The Negri Trust is entitled to piggy back registration rights.

Item 3 Defaults Upon Senior Securities

None

Item 4 Submission of Matters to a Vote of Security Holders

Not Applicable

Item 5 Other Information

The Company intends to file a Certificate of Amendment with the Delaware Secretary of State to change its corporate name from Alternative Technology Resources, Inc. to National Healthcare Exchange Services, Inc. and a Form 15 with the Securities and Exchange Commission to terminate the registration of its common stock and to suspend its duty to file reports required by Section 13(a) under the Securities Exchange Act of 1934.

Item 6 Exhibits and Reports on Form 8-K

a. Exhibits

None.

b. Reports on Form 8-K:

Date of Report	Item(s)	Description
November 12, 2003	4	Changes in Registrant's Certifying Accountants

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.

ALTERNATIVE TECHNOLOGY RESOURCES, INC.

(Registrant)

Dated: February 9, 2004

/s/ Mark W. Rieger

Mark W. Rieger
Chief Executive Officer/Chief Financial Officer