

# AMERICAN TONERSERV CORP.

## FORM 10QSB (Quarterly Report of Financial Condition)

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**UNITED STATES SECURITIES AND EXCHANGE  
COMMISSION  
WASHINGTON, DC 20549**

**FORM 10-QSB**

Quarterly report pursuant section 13 or 15(d) of the Securities  
Exchange Act of 1934

For the quarterly period ended June 30, 2007

Transition report pursuant section 13 or 15(d) of the Securities  
Exchange Act of 1934

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

*Commission File Number: 333-120688*

**AMERICAN TONERSERV CORP.**

(Exact name of small business issuer as specified in its charter)

Delaware  
(State or Other Jurisdiction  
of Incorporation)

33-0686105  
(I.R.S. Employer Identification No.)

475 Aviation Blvd. Suite 100, Santa Rosa, CA 95403  
(Address of Principal Executive Offices)

(800) 736-3515  
(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 is a shell company (as defined  
in Rule 12b-2 of the Exchange Act). Yes  No

Check whether the issuer: (1) filed all reports required to be filed by  
Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the registrant was  
required to file such reports) and (2) has been subject to such filing requirements for the past 90 days: Yes  No

State the shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: On August 14, 2007 there were  
23,643,727 Common Shares outstanding.

Transitional Small Business Disclosure Format (Check One): Yes  No

**AMERICAN TONERSERV CORP. AND SUBSIDIARY  
FORM 10-QSB**

**TABLE OF CONTENTS**

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Condensed Consolidated Balance Sheet	

June 30, 2007 (Unaudited) .....	3
Condensed Consolidated Statements of Operations (Unaudited) Three Months and Six Months Ended June 30, 2007 and 2006....	4
Condensed Consolidated Statements of Cash Flow (Unaudited) Six Months Ended June 30, 2007 and 2006.....	5
Notes to Condensed Consolidated Financial Statements Unaudited) .....	7
Item 2. Management's Discussion and Analysis or Plan of Operation ..	24
Item 3. Controls and Procedures .....	29
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings .....	30
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds .....	30
Item 3. Defaults Upon Senior Securities .....	31
Item 4. Submission of Matters to a Vote of Security Holders .....	31
Item 5. Other Information .....	31
Item 6. Exhibits .....	31
Signatures .....	32

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Condensed Consolidated Balance Sheet**  
(Unaudited)

Six months ended June 30, 2007

**ASSETS**

Current assets:	
Cash and cash equivalents	\$ 241,505
Accounts receivable, net of doubtful accounts of \$12,615	625,515
Inventory	189,220
Prepaid expenses and other current assets	99,013
Deferred compensation	79,459
	-----
Total current assets	1,234,712
Customer lists, net	2,539,699
Goodwill	579,848
Property and equipment, net	119,252
Other assets	27,110
	-----
Total Assets	\$ 4,500,621
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable and accrued expenses	\$ 1,128,653
Notes payable - current portion (net of unamortized discount of \$112,409)	921,582
Deferred revenue	77,257
	-----
Total current liabilities	2,127,492
	-----
Long-term liabilities:	
Notes payable (net of unamortized discount of \$204,829)	971,441
Convertible notes payable, related parties	375,000
Convertible notes payable	675,001
Warrant liabilities	42,165
	-----
Total long-term liabilities	2,063,607
	-----
Total liabilities	4,191,099
	-----
Commitments and contingencies	

Stockholders' equity:	
Convertible preferred stock, \$.001 par value; 50,000,000 Series C authorized shares; 1,925,077 shares issued and outstanding (liquidation preference of \$1,925,077)	1,925
Common stock; \$.001 par value; 450,000,000 shares authorized; 23,643,727 shares issued and outstanding	23,643
Additional paid-in capital	14,876,444
Accumulated deficit	(14,592,490)
	-----
Total stockholders' equity	309,522
	-----
Total Liabilities and Stockholders' Equity	\$ 4,500,621
	=====

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

3

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Condensed Consolidated Statements of Operations**  
(Unaudited)

	Three months ended June 30,		Six months ended June 30	
	2007	2006	2007	2006
	-----	-----	-----	-----
Revenues:				
Toner	\$ 957,743	\$ 9,627	\$ 1,327,527	\$ 12,948
Service	140,887	52,911	161,671	139,486
	-----	-----	-----	-----
Total Revenues	1,098,630	62,538	1,489,198	152,434
	-----	-----	-----	-----
Cost of sales:				
Toner	602,576	4,797	818,540	6,795
Service	133,231	22,477	150,080	56,301
	-----	-----	-----	-----
Total Cost of Sales	735,807	27,274	968,620	63,096
	-----	-----	-----	-----
Gross Profit	362,823	35,264	520,578	89,338
	-----	-----	-----	-----
Operating Expenses:				
Salaries and wages	454,009	26,538	762,873	56,376
Professional fees and services	218,621	33,532	730,520	72,449
Sales and marketing	17,315	9,216	167,336	9,781
General and administrative	408,548	36,956	487,824	83,880
Amortization of customer lists	101,030	-	134,241	-
	-----	-----	-----	-----
Total Operating Expenses	1,199,523	106,242	2,282,794	222,486
	-----	-----	-----	-----
Loss From Operations	(836,700)	(70,978)	(1,762,216)	(133,148)
	-----	-----	-----	-----
Other income (expense):				
Fair value of convertible debt	16,667	-	4,167	-
Interest expense	(62,331)	(22,522)	(94,888)	(46,587)
Change in fair value of warrant liability	5,555	-	5,662	12,827
Gain on claims settlement	-	26,549	1,301	37,357
	-----	-----	-----	-----
Net Loss	\$ (876,809)	\$ (66,951)	\$ (1,845,974)	\$ (129,551)
	=====	=====	=====	=====
Net Loss Per Share:				
Basic and diluted	\$ (0.04)	\$ (0.09)	\$ (0.08)	\$ (0.17)
	=====	=====	=====	=====
Weighted average number of shares outstanding:				
Basic and diluted	23,631,639	771,880	23,293,352	771,880
	=====	=====	=====	=====

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

4

Condensed Consolidated Statements of Cash Flows  
(Unaudited)

	Six months ended 2007	June 30, 2006
	-----	-----
Cash flow from operating activities:		
Net loss for the period	\$(1,845,974)	\$(129,551)
Adjustment to reconcile net loss to net cash used in operating activities:		
Depreciation	13,586	4,939
Amortization	134,241	15,602
Accretion of notes discount	49,184	-
Change in fair value of warrant liability	(5,662)	(12,827)
Fair value of convertible debt	(4,167)	-
Gain on claims settlement	(1,301)	(37,357)
Stock based compensation	510,741	-
Changes in operating assets and liabilities (excluding effect of Optima Technologies, LLC acquisition):		
(Increase) decrease in assets:		
Accounts receivable	(525,032)	15,823
Inventory	(148,429)	-
Prepaid expenses and other current assets	(93,511)	(8,286)
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	594,718	(30,398)
Deferred revenue	75,275	(11,587)
Net cash used in operating activities	(1,246,331)	(193,642)
Cash flow from investing activities:		
Purchase of Optima Technologies, LLC	(866,265)	-
Deferred acquisition costs	(10,000)	-
Purchase of property and equipment	(18,103)	(13,851)
Net cash used in investing activities	(894,368)	(13,851)
Cash flow from financing activities:		
Proceeds from issuance of preferred stock	2,475,000	235,000
Proceeds from issuance of convertible notes payable	100,000	-
Payment of convertible notes	(50,000)	-
Payment of debt on customer list acquisitions	(314,016)	-
Net cash provided by financing activities	2,210,984	235,000
Net increase in cash	70,285	27,507
Cash and cash equivalents, beginning of period	171,220	11,774
Cash and cash equivalents, end of period	\$ 241,505	\$ 39,281
Supplementary information:		
Interest paid	\$ 42,579	\$ -

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

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Condensed Consolidated Statements of Cash Flows (Continued)**  
(Unaudited)

	Six months ended 2007	June 30, 2006
	-----	-----
Supplemental disclosure of noncash investing and financing activities:		
Series C Convertible Preferred stock issued to settle accounts payable	\$ 13,248	\$ -
Series C Convertible Preferred stock issued on conversion of notes payable and interest with warrants	\$ -	\$ 832,884
Issuance of notes payable for acquisition of customer lists	\$ 1,673,911	\$ -

Deferred compensation on restricted stock and option grants to non-employees	\$ 72,878	\$ -
	=====	=====
Issuance of common stock to settle accounts payable	\$ 175,333	\$ -
	=====	=====
Reduction of purchase price of customer list	\$ 128,000	\$ -
	=====	=====

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

6

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**

**Notes to Unaudited Condensed Consolidated Financial Statements**

1. Organization and Business Activity

Managed Maintenance Systems, Inc. was incorporated in the state of Delaware on May 30, 1995. During 1995, Managed Maintenance Systems, Inc. changed its name to "Q MATRIX, Inc." In January 2005, Q MATRIX, Inc. changed its name to AMERICAN TONERSERV CORP. The Company is a national distributor of compatible printer toner cartridges. American TonerServ Corp. services printers and other office equipment through its Preferred Provider Network. The Company is located in Santa Rosa, California.

2. Basis of Presentation and Summary of Significant Accounting Policies Unaudited Interim Financial Information:

The accompanying unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary to state fairly the financial position and the results of operations for the interim periods. The unaudited condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission ("SEC"), but omit certain information and footnote disclosures necessary to present the statements in accordance with accounting principles generally accepted in the United States of America. Results of interim periods are not necessarily indicative of results for the entire year. These unaudited condensed financial statements should be read in conjunction with the American TonerServ Corp. Annual Report on Form 10-KSB for the year ended December 31, 2006.

**Principles of Consolidation:**

The consolidated financial statements include the accounts of American TonerServ Corp. and its wholly-owned subsidiary, Optima Technologies, LLC. (collectively referred to as the "Company"). American TonerServ Corp. is the sole member of Optima Technologies, LLC which is a Delaware Limited Liability Company. Intercompany transactions and balances have been eliminated in consolidation.

**Estimates:**

The preparation of financial statements in conformity with accounting principals generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

7

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**

**Notes to Unaudited Condensed Consolidated Financial Statements**

2. Basis of Presentation and Summary of Significant Accounting Policies  
(Continued)

**Fair Value of Financial Instruments:**

For certain of the Company's financial instruments, including accounts receivable, accounts payable and accrued expenses, the carrying amounts approximate fair value due to the short-term nature of these items. The amounts owed on notes payable also approximate fair value, because the interest rates and terms are offered to the Company at current market rates. On long term debt that is interest free or with below market interest rates an imputed interest rate is used to discount the liabilities.

The Black-Scholes-Merton model is used to value warrants and options. The conversion option, included as a component of convertible debt, is valued using an estimated Private Investment in a Public Entity ("PIPE") price equal to a 20% discount off the fair market value of the stock. The convertible note associated with the Purchase of Optima is valued at the fair value, which approximates the principal balance because the note conversion is at the greater of \$0.50 or the fair market value on the date of conversion.

#### **Inventory:**

Inventory consists of finished goods which is primarily toner cartridges and service parts and is stated at the lower of cost or market determined by the first-in, first-out (FIFO) method.

#### **Property and Equipment:**

Property and equipment is stated at cost less accumulated depreciation. Property and equipment is depreciated using the straight line method over estimated useful lives, which range from three to seven years. Leasehold improvements are depreciated on a straight line basis over the lesser of the lease term or estimated useful life.

#### **Customer Lists:**

The Company accounts for the purchase of customer lists at cost, net of discounts, if any, or fair value if acquired in a business combination, less accumulated amortization. Customer lists are amortized using the straight line method over an estimated useful life of seven years.

The Company uses debt to purchase the customer lists. The debt is interest free or below market rates so the Company discounts these notes using an imputed interest rate of 8-15%. The discounts on the notes are amortized over the term of the notes.

8

### **AMERICAN TONERSERV CORP. AND SUBSIDIARY** **Notes to Unaudited Condensed Consolidated Financial Statements**

#### **2. Basis of Presentation and Summary of Significant Accounting Policies** (Continued)

#### **Long-Lived Assets:**

The Company evaluates the carrying value of its long-lived assets when events or circumstance indicate the existence of a possible impairment, based on projected undiscounted cash flows, and recognizes impairment when such cash flows will be less than the carrying values. Measurement of the amounts of impairments, if any, is based upon the difference between carrying value and fair value of the long lived assets. In June, 2007, management determined that its value of the Computech customer list should be reduced based on a modification to the original customer list purchase agreement. This agreement reduced the purchase price of the customer list by \$128,000.

#### **Revenue Recognition:**

Remanufactured Toner Sales - Revenue for the resale of laser toner cartridges is recognized upon shipment of the toner cartridges to the customer. In the case where the toner cartridge is sold as a bundled product with equipment service included as part of the total purchase price, the combined revenue is segregated between the value of the cartridge and the service components. The cartridge portion is recognized after shipment. The service component is deferred and recognized straight-line over the 90 day period (the maximum term of the service offering with each cartridge).

Time and Materials Maintenance Contracts - Revenue for equipment service calls initiated by the customer is billed based on actual time and materials. The revenue is recognized as the service is provided.

Full Service Maintenance Contracts - Revenue for fixed fee equipment service contracts are recognized on a straight-line basis over the life of the contract.

#### **Deferred Revenue:**

Contract revenue for full-service contracts is recognized by the straight line method over the life of the contract with the unearned portion shown as deferred revenue in the accompanying balance sheet.

#### **Stock Based Compensation:**

The Company has a stock incentive plan (the "Plan"), administered by the Board of Directors, which provides for the granting of options and

shares of common stock to employees, officers, directors and other service providers of the Company. Options granted under the Plan generally are granted with an exercise price equal to the market value of a common share at the date of grant and typically vest over four years from the date of grant.

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Consolidated Financial Statements**

2. Basis of Presentation and Summary of Significant Accounting Policies  
(Continued)

**Stock Based Compensation (Continued):**

On April 19, 2007, the Board of Directors authorized a 1,600,000 increase in the plan to 10,000,000 shares, which was approved by a majority of the stockholders. The total number of shares authorized to be granted under the 2005 plan was 10,000,000 at June 30, 2007. The 1995 Stock Option Plan has expired but all options outstanding at that time continue in accordance with their respective terms. No new options will be granted under the 1995 Plan and there were 35,133 options outstanding under the 1995 Plan.

The estimated fair value of equity-based awards, less expected forfeitures, is amortized over the awards' vesting period on a straight-line basis. Share-based compensation expense recognized in the consolidated statements of operations relating to stock options for the three and six-month periods ended June 30, 2007 was \$128,344 and \$213,740 respectively. We have not recorded income tax benefits related to equity-based compensation expense as deferred tax assets are fully offset by a valuation allowance.

In calculating compensation related to stock option grants, the fair value of each stock option is estimated on the date of grant using the Black-Scholes-Merton option-pricing model and the following weighted average assumptions:

	Six months ended June 30, 2007	Six months ended June 30, 2006
	-----	-----
Dividend yield	None	-
Expected volatility	35.0%	-
Risk-free interest rate	4.5%-5.1%	-
Expected terms (years)	5.7-6.3	-

The Company calculates the expected volatility for stock-based awards using the historical volatility for its peer group public companies because sufficient historical data does not yet exist for the Company's stock. The risk free interest rates were determined by the rates of the 5 and 7 year treasury bills on the grant date of the options. The expected term was determined in accordance with Staff Accounting Bulletin No. 107.

The Company records the fair value of restricted stock and options granted to non-employees as deferred compensation at the date of issuance and recognizes compensation pro rata over the service period of the restricted stock or options. The compensation is adjusted for the change in fair market value at the end of each period.

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Consolidated Financial Statements**

2. Basis of Presentation and Summary of Significant Accounting Policies  
(Continued)

**Net Loss per Share:**

Net loss per share has been calculated using the weighted average number of shares outstanding during the period. Diluted loss per common share are computed similar to basic loss per share except that the weighted average number of common shares outstanding is increased to include additional common shares from the assumed exercise of options and warrants and conversion of convertible debt, if dilutive. Dilutive loss per share is the same as basic loss per share in all periods, since the impact of outstanding options and warrants is antidilutive.

The following securities could potentially dilute basic earnings per share in the future:

June 30, 2007	June 30, 2006
-----	-----

Options	8,444,036	58,140
Common Stock Warrants - 1998 & 1999 grants		50,729
Common Stock Warrants - Convertible debt	593,412 (1)	-
Convertible debt	1,829,268 (2)	-
Convertible Preferred Stock	19,250,770 (3)	-
Convertible debt - Optima	600,000 (4)	-
	-----	-----
Potential equivalent shares excluded	30,717,486	108,869
	=====	=====

(1) In addition to the outstanding options and common stock warrants, the Company has issued \$600,000 of notes as of June 30, 2007 that are convertible into common stock at a conversion price equal to the price of shares sold in a future offering of common stock. The holders of these notes also hold warrants that may be exercised to purchase a number of shares equal to 30% to 150% of the number of shares each holder would receive if their notes are converted into common stock. The exercise price of the warrants will be equal to the price of shares sold in the offering of common stock. The Company estimated the number of warrants based on the fair value of common stock of \$0.41 per share at June 30, 2007.

(2) Convertible debt was calculated based on \$600,000 of convertible notes outstanding using an estimated conversion price of \$0.33 per share, which represents a discount of 20%, the estimated discount of a PIPE offering, of the fair value of common stock of \$0.41 per share at June 30, 2007.

(3) Preferred Series C Convertible Shares are convertible into ten shares of the Company's common stock at the option of the holders.

11

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Consolidated Financial Statements**

2. Basis of Presentation and Summary of Significant Accounting Policies  
(Continued)

**Net Loss per Share (continued):**

(4) The convertible note to Optima was calculated based on the share price of \$0.50 per share of the terms of the agreement dated April 1, 2007.

**Convertible Debt Securities:**

The Company has issued convertible debt securities with non-detachable conversion features. The Company accounts for such securities on the condensed consolidated balance sheet as a component of the overall fair value of the securities. The Company estimates fair value based on the intrinsic value of common stock by determining the difference between the total shares converted at fair value and the total shares converted at a 20% discount, which is the estimated discount of a PIPE offering.

**Warrants and Detachable Warrants:**

The Black-Scholes-Merton option pricing method was used to value the warrants and detachable warrants. A \$0.33 per share value was attached to the warrants, which represents a discount of 20%, the estimated discount of a PIPE offering, of the fair value of common stock of \$0.41 per share at June 30, 2007, a 35% volatility and a risk free interest rate ranging from 4.7 to 5.1% based on the estimated life of nine months of the warrants.

As the warrant contracts must be settled by the delivery of registered shares and the delivery of the registered shares are not controlled by the Company, the estimated fair value of the warrants at the date of issuance was recorded as a warrant liability on the balance sheet. The total warrant liabilities as of June 30, 2007 was \$42,165.

3. Going concern:

These condensed consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its obligations in the normal course of business.

The Company had a loss of \$(1,845,974) and had negative cash flows from operations of \$(1,246,331) for the six month period ended June 30, 2007 and had an accumulated deficit of \$(14,592,490) and a working capital deficit of \$(892,780) at June 30, 2007. The Company continues to settle overdue claims from certain service providers resulting in a net gain of \$1,301 during the six months ended June 30, 2007. The Company

has significant cash requirements and is not generating sufficient cash flows from existing operations. The Company has insufficient funds to meet its financial obligations as they become due as operations are currently using cash of approximately \$175,000 per month.

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Consolidated Financial Statements**

3. Going concern (continued):

Management believes it will be successful in financing its operations for the next twelve months. However, until such time as financing is obtained, there can be no assurance that sufficient funds will be available to finance its operations. This raises substantial doubt about the Company's ability to continue as a going concern. It is management's objective to seek additional capital and funding sources to finance its future operations. The Company raised \$2,575,000 through private offerings during the six months ended June 30, 2007. The condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence. Although the Company will continue to seek additional cash resources through equity issuances in order to position the Company for possible future opportunities, there can be no assurance that funds will be available on an economic basis to the Company.

4. Acquisitions

On April 1, 2007, the Company entered into an Asset Purchase Agreement ("Agreement") with Optima Technologies, L.L.C., a Nevada limited liability company ("Optima"), and Steven R. Jensen, who owns all of the membership interests in Optima relating to the purchase of certain assets of Optima's printer business. The purchase price for the acquisition consisted of \$741,278 in cash, \$124,987 in acquisition costs and \$1,800,000 in the form of three promissory notes. The Company also assumed certain liabilities of Optima of \$76,825 and the obligations of Optima under certain contracts.

One of the promissory notes (the "Secured Note") in the amount of \$250,000 bears interest at the rate of 7% per annum and is due within 105 days after the closing date. The Secured Note is secured by the assets purchased in the transaction. The note has been discounted 8% for a combined imputed interest rate of 15%. The discount of \$5,624 will be amortized over the term of the note.

One of the promissory notes (the "Contingent Note") is in the amount of \$1,250,000 and bears interest at the rate of 7% per annum. The Contingent Note is subject to adjustment as described below. The Contingent Note is payable in thirty equal monthly installments of principal and interest, commencing on May 1, 2007. The note has been discounted 8% for a combined imputed interest rate of 15%. The discount of \$120,465 will be amortized over the term of the note.

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Consolidated Financial Statements**

4. Acquisitions (continued):

The principal amount of the Contingent Note will be adjusted in the event that the gross profit (as defined in the Agreement) of the printer business is higher or lower than levels specified in the Agreement and Contingent Note. If such gross profit during the 18 month period exceeds \$3,018,750, the Contingent Note will be increased by 50% of the amount that gross profit exceeds that amount. If such gross profit is less than \$2,231,250, the Contingent Note will be decreased by the amount that the gross profit is below \$2,231,250. If the gross profit is between \$2,231,250 and \$3,018,750, no adjustment will be made. The Company believes that the likelihood that gross profit will not exceed \$2,231,250 is remote. Accordingly, the Company has included the entire note of \$1,250,000 in the purchase price.

One of the promissory notes (the "Convertible Note"), in the amount of \$300,000, has a maturity date two years after the closing date. On the maturity date, the Convertible Note will automatically be converted into the number of shares of the Company's common stock that is equal to the quotient obtained by dividing (i) the aggregate outstanding principal balance due on the Convertible Note, by (ii) the greater of (A) \$0.50 per share, or (B) the average of the closing bid and asked prices of the common stock quoted in the over-the-counter market in which the common stock is traded for the five (5) trading days prior to the closing date and the five trading days on and after the closing date. This note is interest free and has been recorded at fair value due to the conversion option similar to other convertible debt.

In connection with the closing of the acquisition, the Company entered into a Management Agreement with Optima and Steven R. Jensen that provides that Optima will serve as the manager of the Company's operations acquired from Optima for a period of thirty months, with an option for the Company to extend the agreement for an additional eighteen months. The Management Agreement provides for an annual management fee of \$522,429 to be paid to Steven R. Jensen in consideration for certain services, including, without limitation, support staffing, master software license, and office and warehouse facilities. The management fee will be adjusted annually to reflect a cost of living increase, and periodically to reflect changes in personnel.

Also in connection with the closing of the acquisition, the Company entered into a Management Agreement with Axon Technologies, Inc. ("Axon"), a non-profit organization that employs persons with disabilities and produces remanufactured toner cartridges. Axon distributes its products to Florida state agencies. Under this Management Agreement, Optima will provide management services for Axon and will receive a management fee equal to 90% of the amounts received by Axon for its products.

14

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Consolidated Financial Statements**

4. Acquisitions (continued):

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. The Company is in the process of obtaining third-party valuations of certain intangible assets; thus, the allocation of the purchase price is subject to refinement.

Vehicles and equipment	\$ 87,362
Inventory	40,791
Customer list	1,899,000
Goodwill	579,848
Covenant not to compete	10,000
	-----
Total assets acquired	2,617,001
	-----
Notes payable - vehicles	(76,825)
	-----
Net assets acquired	\$2,540,176
	=====

15

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Consolidated Financial Statements**

4. Acquisitions (continued):

The unaudited pro forma combined statements of operations for the six month periods ended June 30, 2007 and 2006 presented below assumes that the acquisition of certain assets of Optima Technologies, LLC was completed on January 1, 2007 and 2006, respectively:

	June 30, 2007	June 30, 2006
	-----	-----
Revenues:		
Toner	\$ 2,042,136	\$ 1,671,779
Service	289,266	332,869
	-----	-----
Total Revenues	2,331,402	2,004,648
	-----	-----
Cost of sales:		
Toner	1,198,187	835,706
Service	255,676	267,494
	-----	-----
Total Cost of Sales	1,453,863	1,103,200
	-----	-----
Gross profit	877,539	901,448
	-----	-----
Operating Expenses:		
Salaries and wages	799,532	144,984
Professional fees and services	730,520	72,449
Sales and marketing	196,451	97,485
General and administrative	653,417	427,413
Amortization of customer lists	202,062	135,642
	-----	-----
Total Operating Expenses	2,581,982	877,973
	-----	-----
(Loss) gain from operations	(1,704,443)	23,475
	-----	-----
Other income (expense):		
Fair value of convertible debt	4,167	-
Interest expense	(126,203)	(109,217)
Change in fair value of warrant liability	5,662	12,827
Gain on claims settlement	1,301	37,357
	-----	-----

Net Loss	\$ (1,819,516)	\$ (35,558)
	=====	=====
Net Loss per share:		
Basic and diluted	\$ (0.08)	\$ (0.05)
	=====	=====

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Consolidated Financial Statements**

4. Acquisitions (continued):

The adjustments and methodology used in allocating the purchase consideration for Optima and in the preparation of these unaudited pro forma combined statements of operations are based on estimates, available information and certain assumptions which may be revised as additional information becomes available. The pro forma financial data do not purport to represent what the Company's combined results of operations would actually have been if such acquisition had in fact occurred at the beginning of the periods, and are not necessarily representative of the Company's results of operations for any future period since the companies were not under common management or control during the periods presented.

5. Computech Customer List

On June 11, 2007, the Company entered into an amendment to the customer list acquisition agreement with Computech Printer Solutions, Inc. ("Computech"). The Company will pay \$7,500 over a three month period. The first payment due on June 16, 2007, was made in the amount of \$2,500. Computech will also receive five percent of the gross sales through December 31, 2007. Because of this agreement the purchase price of the customer list was reduced by \$128,000. Accordingly, the note payable was also reduced by \$128,000. The conversion valuation in the amount of \$16,667 has also been reversed since a portion of the note is no longer convertible into the Company's common stock.

6. Recent Accounting Pronouncements:

In July 2006, the FASB issued FIN 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109" ("FIN 48") which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 is a comprehensive model for how a Company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the Company has taken or expects to take on a tax return. If an income tax position exceeds a more likely than not (greater than 50%) probability of success upon tax audit, the Company will recognize an income tax benefit in its financial statements. Additionally, companies are required to accrue interest and related penalties, if applicable, on all tax exposures consistent with jurisdictional tax laws. This interpretation is effective on January 1, 2007. There was no impact from FIN 48 as the Company has not taken nor expects to take any uncertain tax positions on a tax return.

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Financial Statements**

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7. Convertible Notes

In March 2007, the Company completed the sale of two Units of securities in a private offering at a purchase price of \$50,000 per Unit. Each Unit consists of a 10% Convertible Note in the principal amount of \$49,999 (the "Notes") and a detachable warrant to purchase shares of the Company's Common Stock (the "Warrants"). The Notes bear interest at the rate of 10% per annum and become due and payable in full two years after issuance. The Notes may be converted, at the option of the holder, into shares of Common Stock upon the sale and issuance of common stock by the Company in a PIPE offering resulting in gross proceeds of not less than \$3,000,000 (a "\$3 Million Qualified Offering"). The conversion term will expire six months after the Company completes a \$3 Million Qualified Offering. The Notes will be automatically converted into shares of common stock upon the sale and issuance of common stock by the Company in a PIPE offering resulting in gross proceeds of not less than \$5,000,000 (a "\$5 Million Qualified Offering"). The price at which this Note may be converted into Common Stock (the "Conversion Price") shall be the average price at which the first \$1.0 million of Common Stock is sold in a \$3 Million or \$5 Million Qualified Offering, whichever may occur.

The conversion option feature of these notes has been valued based on a 20% discount of the stock at \$0.33 per share, which is the estimated discount in a PIPE offering of the fair value of common stock of \$0.41 per share at June 30, 2007. This conversion option is included in the fair value of these notes. These notes also contain detachable warrants equal to 40% of the face value of the note. In assessing the fair value of the warrant grants, the Company recorded the fair value of these instruments based on the Black-Scholes-Merton model which requires estimates of the volatility of our stock and the market price of our shares, which was \$0.41 per share at June 30, 2007.

In calculating the warrant liability, the fair value of each warrant is estimated at the end of each period using the Black-Scholes-Merton model

and the following weighted average assumptions:

	Six months ended June 30, 2007
Dividend yield	None
Expected volatility	35.00%
Risk-free interest rate	4.50%
Expected terms (years)	0.75

18

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Financial Statements**

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8. Preferred Stock

During the six months ended June 30, 2007, the Company received subscriptions for 807,193 shares of Series C preferred stock (Series C Shares) from accredited investors in a private offering for \$2,475,000 in cash and 13,248 for past due vendor accounts that were settled.

The Series C Shares are convertible into ten shares of the Company's common stock at the option of the holders. The holders of the Series C Shares will vote together with the holders of common stock on an "as if converted" basis. The holders of the Series C Shares will also be entitled to vote as a separate class as required by Delaware law. Holders of Series C Convertible Preferred Stock will receive dividends only when and if declared by the Board of Directors of the Company and no dividends shall accumulate on the Series C Convertible Preferred Stock.

9. Stock-based Compensation

On February 22, 2007, the Company issued 389,630 shares of common stock for services previously rendered to the Company that were accrued at December 31, 2006. The number of shares issued was based on the share price of \$0.45, which is the fair market value of stock as of the date of issuance. Dan Brinker, Chief Executive Officer, received 66,667 shares for a total of \$30,000 in compensation. Aaron Brinker, Chief Operating Officer, received 45,185 shares for a total of \$20,333 in compensation. Ryan Vice, Chief Financial Officer, received 26,667 shares for a total of \$12,000 in compensation. Andrew Beaurline, Vice President of Corporate Development and Strategy received 228,889 shares for a total of \$103,000 in compensation, of which \$45,000 related to consulting services prior to his employment with the Company. Chuck Mache, advisor, received 22,222 shares for a total of \$10,000 in compensation.

On March 27, 2007, the Company entered into an agreement with Fort Holdings Limited to pay for services rendered to the Company during the three months ending March 31, 2007, in stock valued at \$177,000. These shares were priced at \$0.40 per share for a total of 442,500 common shares.

On April 1, 2007, the Company issued 4,717 shares of common stock for services previously rendered to the company by Chuck Mache. These shares were issued at \$0.53 per share for a total of \$2,501 in compensation.

On May 15, 2007, the Company issued 25,000 shares of common stock for services previously rendered to the Company by Henry Manayan. These shares were issued at \$0.45 per share for a total of \$11,250 in compensation.

19

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Financial Statements**

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10. Restricted Stock

On July 7, 2006, the Company's Board of Directors entered into a Corporate Development and Consulting Agreement with Fort Holdings Ltd., a British Virgin Island corporation ("Fort Holdings"), under which Fort Holdings will provide corporate and business development, planning and financial consulting services to the Corporation. As compensation for these services, Fort Holdings received a \$10,000 retainer and 1,500,000 shares of the Company's Common Stock. The fair value of this stock when granted was \$0.015 per share. Restricted shares totaling 1,000,000 shares became vested as of January 7, 2007 due to the Corporate Development and Consulting Agreement still being in effect after six months as stated in the agreement. As of February 28, 2007, the Corporate Development and Consulting Agreement was completed and the remaining 500,000 shares were vested immediately. The total compensation recognized during the six months ending June 30, 2007 was \$102,500.

Restricted shares have the same voting and dividend rights as the Company's unrestricted common shares.

Compensation cost for restricted stock is recognized in the financial statements on a pro rata basis over the vesting period for employees. During the three and six months ended June 30, 2007 the Company recognized \$1,875 and \$3,750, respectively, in compensation expense.

A summary of the changes in restricted stock outstanding during the six months ended June 30, 2007 is presented below:

	Shares	Weighted Average Grant Date Fair Value
	-----	-----
Non-vested shares at January 1, 2007	2,500,000	\$0.015
Granted	-	-
Vested	(1,500,000)	\$0.015
Forfeited/Expired	-	-
	-----	-----
Non-vested shares at June 30, 2007	1,000,000	\$0.015
	=====	=====

As of June 30, 2007, there was \$7,500 of total unrecognized compensation cost related to restricted stock. The weighted average vesting period remaining for the restricted stock is one year.

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Financial Statements**

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11. Stock Option Plan

On February 9, 2007, the Company engaged four individuals to serve on its Strategic Advisory Board. These individuals were granted 100,000 options each at \$0.40 a share to serve a one year term. The options will vest equally over the twelve month term.

On February 15, 2007, the Board of Directors granted options to purchase 50,000 shares of common stock to an employee. The exercise price of these options was \$0.45 per share with a vesting period of four years.

On March 26, 2007, the Board of Directors granted options to purchase 50,000 shares of common stock to an employee. The exercise price of these options was \$0.45 per share with a vesting period of four years.

On May 14, 2007, the Board of Directors granted options to purchase 500,000 shares to Michael Ducey, our Senior Vice President of Sales and Marketing. The exercise price of these options was \$0.60 per share with a vesting period of four years.

On May 31, 2007, the Board of Directors granted options to purchase 6,300 shares of common stock to each of two employees. The exercise price of these options was \$0.50 per share with a vesting period of four years.

A summary of the changes in stock options outstanding under our equity- based compensation plans during the six months ended June 30, 2007 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
	-----	-----	-----	-----
Outstanding at January 1, 2007	7,442,640	\$0.17	9.67	\$2,386,274
Granted	1,012,600	\$0.43	9.75	\$ 4,000
Exercised	-	-	-	-
Forfeited/Expired	(11,207)	\$2.50	-	-
	-----	-----	-----	-----
Outstanding at June 30, 2007	8,444,033	\$0.20	9.21	\$1,891,713
	=====	=====	=====	=====
Exercisable at June 30, 2007	1,460,283	\$0.23	9.07	\$ 330,065
	=====	=====	=====	=====

The weighted average grant date fair value of options granted during the six-month period ended June 30, 2007 was \$0.43.

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Financial Statements**

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11. Stock Option Plan (Continued)

As of June 30, 2007, there was approximately \$385,377 of total unrecognized compensation cost related to non-vested options granted under the plans, which is expected to be recognized over a weighted average period of 2.49 years, of which \$79,459 is recorded as deferred compensation. The total fair value of options vested was \$115,712 during the six-month period ended June 30, 2007. No options were exercised during the six-month period ended June 30, 2007.

12. Letter of Credit

On June 6, 2007, the Company secured a credit facility in the amount of \$960,000 from a bank. This facility will be used to provide Standby Letters of Credit to secure standard terms from certain vendors. This credit facility has a maturity date of June 30, 2008 and is personally guaranteed by Daniel Brinker, William Robotham and Thomas Hakel. Any draws on the letter of credit will accrue interest at 5 percent over the prime rate.

13. Commitments and Contingencies

As of June 30, 2007 the Company was not involved in any pending litigation regarding claims against the Company. In the past, we have been subject to claims arising in the ordinary course of business, primarily vendor disputes.

14. Subsequent Events

On July 20, 2007, the Board of Directors granted options to purchase 75,000, 85,000 and 100,000 shares to Michael Talbott, David Curtas and James Egan in accordance with the terms of their employment agreements with Optima Technologies, LLC. The exercise price of these options was \$0.52 per share with a vesting period of four years.

On July 5, 2007, the Company was served with a notice of charge of discrimination by a former independent sales representative (ISP) for alleged acts by another ISP. The claimant is seeking total monetary damages in the amount of \$150,000. The Company is awaiting a response from the United States Equal Employment Opportunity Commission. The Company believes it has minimal or no liability as the Company is protected by indemnification provisions within the ISP agreements.

On July 19, 2007, the Company was sued in civil court by an individual for \$7,500 for anti-spam violations. The Company believes it had nothing to do whatsoever with the allegations in this summons of civil action.

On August 7, 2007, the Company entered into an Agreement which modifies the Asset Purchase Agreement with Optima entered into on April 1, 2007 relating to the purchase of certain assets by the Company. The Letter Agreement modifies the terms of the Asset Purchase Agreement and certain related documents.

**AMERICAN TONERSERV CORP. AND SUBSIDIARY**  
**Notes to Unaudited Condensed Financial Statements**

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14. Subsequent Events (Continued)

The parties will amend the Management Agreement dated April 1, 2007 (the "Management Agreement"), whereby the Company will pay AMG \$100,000 on or before October 8, 2007, for the right to unilaterally terminate the Management Agreement (the "Subsidiary Termination Right"). Upon the exercise of the Subsidiary Termination Right, the Company will pay AMG an amount equal to \$25,000 multiplied by the number of months remaining in the term of the Management Agreement minus the \$100,000 paid as stated above.

The Company will buy from AMG certain inventory for \$350,000 payable in six equal monthly payments plus interest thereon at the rate of 10% per annum.

The Secured Promissory Note has been modified to provide that the Company shall pay \$280,000 to AMG on or before August 13, 2007, which amount will cover the principal plus all interest, late fees and other costs under the Secured Promissory Note. This payment was made on August 13, 2007.

The Company will continue to make the scheduled monthly installment payments under the Contingent Promissory Note dated April 1, 2007, until March 1, 2008, at which time the entire outstanding principal balance and unpaid accrued interest shall be due and payable. The Contingent Note was also amended to eliminate the gross profit requirements of the note. In addition, the Contingent Promissory Note shall be secured by the accounts receivable and inventory of Subsidiary, which shall be added to the description of collateral under the Security Agreement dated April 1, 2007; provided, however, such security interest shall be subordinated to any financing of ATS of at least \$3 million.

The parties have agreed to promptly and in good faith, prepare, negotiate and execute definitive documents or other instruments as may be necessary to fully effect the agreements contained in the Agreement.

On August 13, 2007, the Company elected Steven R. Jensen to the Company's Board of Directors for a term equal with the term of the Management Agreement. The Company also granted Mr. Jensen an option to purchase 300,000 shares of common stock at an exercise price of \$0.36 per share. The option will vest 10,000 shares per month.

In August 2007, William Robotham, Director, advanced the Company \$280,000 to fund the Optima Secured Note payment due August 13, 2007.

23

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION**

This Report contains statements that may contain forward-looking statements, concerning the Registrant's future operations and planned future acquisitions and other matters and the Registrant intends that such forward-looking statements be subject to the safe harbors for such statements. Any statements that involve discussions with respect to predictions, expectations, belief, plans, projections, objectives, assumptions or future events or performance (often, but not always, using phrases such as "expects", or "does not expect", "is expected", "anticipates" or "does not anticipate", "plans", "estimates" or "intends", or stating that certain actions, events or results "may", "could", "might", or "will" be taken to occur or be achieved) are not statements of historical fact and may be "forward looking statements". These forward-looking statements include statements relating to, among other things, the ability of the Registrant to continue as a going concern.

The Company cautions readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Such forward-looking statements are based on the beliefs and estimates of the Company's management as well as on assumptions made by and information currently available to the Company at the time such statements were made. Forward looking statements are subject to a variety of risks and uncertainties which could cause actual events or results to differ from those reflected in the forward looking statements, including, without limitation, the failure to obtain adequate financing on a timely basis. Actual results could differ materially from those projected in the forward-looking statements, either as a result of the matters set forth or incorporated in this Report generally and certain economic and business factors, some of which may be beyond the control of the Registrant. Additional risks and uncertainties that may affect forward-looking statements about the Company's business and prospects include adverse economic conditions, inadequate capital, unexpected costs, and other factors set forth under "Risk Factors" in its Registration Statement on Form SB-2, which could have an immediate and material adverse effect. The Company disclaims any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

This following discussion and analysis of the results of operations and financial condition of the Company should be read in conjunction with the audited financial statements for the period ended December 31, 2006 and the related notes, contained in the Company's Annual Report on Form 10-KSB and in conjunction with the unaudited financial statements and notes thereto appearing elsewhere in this Form 10-QSB.

### **Three Months Ended June 30, 2007 and 2006**

Revenue. Revenue for the three months ended June 30, 2007 ("Q2 2007") was \$1,098,630 as compared to \$62,538 for the three month period ended June 30, 2006 ("Q2 2006"). The increase in revenue in Q2 2007 was primarily due to revenues that resulted from one asset purchase agreement that was closed in April of 2007 and three customer list acquisitions from toner distributors that occurred in the second half of 2006. Revenues from the sale of toner cartridges increased by \$948,116 for three months ended June 30, 2007 compared to 2006.

24

Revenues from service increased by \$87,976 for the three months ended June 30, 2007 compared to 2006 due to the Optima asset purchase, offset by the non-renewal of full-service maintenance agreements.

Gross Profit (Revenue less Cost of Goods Sold). Gross profit for Q2 2007 increased to \$362,823 from \$35,264 in Q2 2006. The gross profit margin in Q2 2007 was 33% compared to a gross profit margin for Q2 2006 of 56%. The Company's gross margins decreased compared to Q2 2006 due to the higher margins associated with service revenues on office equipment as compared to toner sales and the amortization of customer lists that were purchase in the second half of 2006 and in April of 2007. Since toner sales represented a greater portion of total

revenues in 2007 as compared to 2006, the gross profit margin decreased.

**Salaries and Wages.** Salaries and Wages expenses were \$454,009 for Q2 2007 compared to \$26,538 in Q2 2006. The Q2 2007 increase was due to the Company having 33 full-time employees, including the management team, during Q2 2007 compared to 2 full-time employees in Q2 2006. Stock based compensation also accounted for \$40,631 of this expense in Q2 2007.

**Professional Fees and Services.** Professional Fees and Services expenses were \$218,621 in Q2 2007 compared to \$33,532 in Q2 2006. This increase was primarily due to stock compensation recognized by the Company's advisory board in the amount of \$84,174. The Company also incurred additional legal and accounting fees due to the additional SEC filings, consulting payments relating to our Sun Products acquisition and an increase in Netsuite software support.

**Sales and Marketing.** Sales and Marketing expenses were \$17,315 for Q2 2007 and \$9,216 in Q2 2006. This increase in Q2 2007 was primarily due to the hiring of an advertising consultant, sales commissions relating to the Company's Independent Sales Partners, investor relations and industry magazine advertising.

**General and Administrative.** General and Administrative expenses were \$375,337 in Q2 2007 and \$36,956 in Q2 2006. General and Administrative expenses increased due to the Company's acquisition of Optima, beginning a health plan, additional rent for office space and an overall increase to support 31 additional employees compared to Q2 2006.

**Amortization of Customer Lists.** Amortization expense was \$101,030 in Q2 2007 compared to none in Q2 2006. This increase was due to the Company's acquisitions in the second half of 2006 and the first half of 2007.

**Other Income (Expense).** Q2 2007 had an increase of \$38,809 in interest expenses relating to additional convertible notes sold in a private offering and notes issued in connection with the Company's acquisitions. There was an increase in the change in the fair value of the warrant liability of \$5,555 for Q2 2007 compared to Q2 2006. There was no gain on claims settlement for Q2 2007 compared to \$26,549 for Q2 2006.

**Net Loss.** The net loss for the three months ended June 30, 2007 was \$876,809 compared to \$66,951 for the three months ended June 30, 2006. The increase in the net loss of \$809,858 for Q2 2007 was primarily attributable to stock related compensation totaling \$124,805, Optima's net loss of \$177,166, increased legal and accounting fees, and additional salaries and wage expense due to the Company hiring additional personnel to support its objective of acquiring toner distributors.

25

**Net Loss) per Share.** The net loss per share in Q2 2007 was \$(0.04) compared to a loss of \$(0.09) in Q2 2006. The Company believes that it will continue to have net losses for the foreseeable future.

### **Six Months Ended June 30, 2007 and 2006**

**Revenue.** Revenue for the six months ended June 30, 2007 ("YTD 2007") was \$1,489,198 as compared to \$152,434 for the six month period ended June 30, 2006 ("YTD 2006"). The increase in revenue in YTD 2007 was primarily due to revenues that resulted from the Company's three customer list acquisitions it made in the second half of 2006 and an asset purchase of a toner distributor that was completed on April 1, 2007. Revenues from the sale of toner cartridges increased by \$1,314,579 for the six months ended June 30, 2007 compared to 2006. Revenues from service increased by \$22,185 for the six months ended June 30, 2007 compared to 2006.

**Gross Profit (Revenue less Cost of Goods Sold).** Gross profit for YTD 2007 increased to \$520,578 from \$89,338 in YTD 2006. The gross profit margin, excluding the amortization of the customer lists, in YTD 2007 was 35% compared to a gross profit margin for YTD 2006 of 59%. The Company's gross margins decreased compared to YTD 2006 due to the higher margins associated with service revenues on office equipment as compared to toner sales and the amortization of customer lists that were purchase in the second half of 2006 and in April of 2007. Since toner sales represented a greater portion of total revenues in 2007 as compared to 2006, the gross profit margin decreased.

**Salaries and Wages.** Salaries and Wages expenses were \$762,873 for YTD 2007 compared to \$56,376 in YTD 2006. The YTD 2007 increase was due to the Company having 33 full-time employees, including the management team, during YTD 2007 compared to 2 full-time employees in YTD 2006. Stock based compensation also accounted for \$85,955 of this expense.

**Professional Fees and Services.** Professional Fees and Services expenses were \$730,520 in YTD 2007 compared to \$72,449 in YTD 2006. This increase was primarily due to \$383,000 of costs associated with the Company's Corporate Development Plan agreement with Fort Holdings Limited. A portion of this amount was \$279,501 paid in the form of common stock. The Company also recognized \$145,285 in stock option expense for their strategic advisory board.

**Sales and Marketing.** Sales and Marketing expenses were \$167,336 for YTD 2007 and \$9,781 in YTD 2006. This increase in YTD 2007 was primarily due to the hiring of an advertising consultant, sales commissions relating to the Company's Independent Sales Partners, investor relations and industry magazine advertising.

General and Administrative. General and Administrative expenses were \$487,824 in YTD 2007 and \$83,880 in YTD 2006. General and Administrative expenses increased due to the Company beginning a health plan, additional rent for office space and an overall increase to support 31 additional employees compared to YTD 2006.

Amortization of Customer Lists. Amortization expense was \$134,241 in YTD 2007 compared to none in YTD 2006. This increase was due to the Company's acquisition in the second half of 2006 and the first half of 2007.

26

Other Income (Expense). YTD 2007 had an increase of \$48,301 in interest expenses relating to convertible notes payable related to the Company raising money through a private offering and notes relating to acquisitions. There was a decrease in the change in the fair value of the warrant liability of \$7,165 for YTD 2007 compared to YTD 2006. The gain on claims settlement was \$1,301 for YTD 2007 compared to \$37,357 YTD 2006. Conversion option gain was \$4,167 for YTD 2007 compared to none in YTD 2006.

Net Loss. The net loss for the six months ended June 30, 2007 was \$1,845,974 compared to \$129,551 for the six months ended June 30, 2006. The increase in the net loss of \$1,716,423 for YTD 2007 was primarily attributable to stock related compensation totaling \$510,741, payments made to Fort Holdings Limited for \$100,000 for the Company's Corporate Development Plan, increased legal and accounting fees, additional salaries and wage expense due to the Company hiring additional personnel to support its objective of acquiring toner distributors.

Net Loss per Share. The net loss per share in YTD 2007 was \$(0.08) compared to a loss of \$(0.17) in YTD 2006.

The Company believes that it will continue to have net losses for the foreseeable future.

### **Liquidity and Capital Resources**

At June 30, 2007, the Company had a working capital deficit of \$892,780 including cash and equivalent balances of \$241,505 compared to a working capital deficit of \$572,067 at December 31, 2006 including cash and equivalent balances of \$171,220. The Company will need to secure additional funding sources to meet its need for working capital and to complete the proposed acquisition of Tonertype.

Accounts receivable increased \$525,032 from \$100,483 at December 31, 2006 to \$625,515 at June 30, 2007. This was primarily due to increased revenues from the Optima acquisition and the three customer list acquisitions in the second half of 2006.

Accounts payable and accrued expenses, which consist primarily of amounts due to third party service providers and toner suppliers, increased \$404,836 from \$723,817 at December 31, 2006 to \$1,128,653 at June 30, 2007. The increase was primarily due to the Company's Optima acquisition and the three customer list acquisitions in the second half of 2006.

The Company has entered into no derivative financial instrument arrangements for the six months ended June 30, 2007.

During the six months ended June 30, 2007, the Company raised \$100,000 in gross proceeds from a private offering of Units consisting of a convertible notes and warrants and \$2,475,000 in gross proceeds from a private offering of Preferred Series C shares. The notes bear interest at the simple rate of ten percent (10%) per year, payable monthly. The notes are due and payable in full two years from the date of issuance. Each unit includes a warrant to purchase shares of our Common Stock. The number of shares that may be purchased pursuant to each warrant will equal approximately 30% of the number of shares a holder would receive if the holder converted their notes into shares of the Company's common stock.

27

The notes may be converted, at the option of the holder, into shares of our Common Stock upon the occurrence of a Private Investment in a Public Entity offering ("PIPE offering") undertaken by the Company that raises a minimum of \$3.0 million. The price at which the note may be converted into Common Stock will be the average price at which the first \$1.0 million of Common Stock is sold in a PIPE offering, as defined in the note.

The Company currently has no external sources of liquidity.

During the six months ended June 30, 2007, the Company used \$1,246,331 in cash from operations. The cash flows were used primarily to finance the Company's continued losses from operations. The Company does not expect to generate sufficient cash from existing operations to meet its capital requirements in the short or long term, which makes the Company's ability to continue as a going concern questionable. Management believes it will be successful in financing its operations for the next twelve months. However, until such time as financing is obtained, there can be no assurance that sufficient funds will be available to finance its operations.

During the six months ended June 30, 2007, the Company used \$894,368 in cash from investing activities. The cash flows were used primarily for the Company's asset purchase of Optima Technologies, LLC.

During the six months ended June 30, 2007, the Company received \$2,210,984 in cash from financing activities. These cash flows were primarily from \$2,475,000 for the issuance of preferred stock offset by \$(364,016) in payments on debt relating to customer lists and convertible notes.

## **Business Outlook, Risks and Uncertainties**

### **Economic Uncertainties**

Current economic slowdown, financial market conditions, and the political environment may affect the Company's ability to raise financing. The Company will be required to raise additional capital to establish business operations. The uncertainty about the Company's ability to raise financing makes it difficult to predict the Company's results for fiscal year 2007 and its ability to continue as a going concern.

### **Sufficiency of Working Capital**

As of June 30, 2007, the Company had a net working capital deficit of \$892,780. The Company has inadequate financial resources to sustain its business activities. The Company currently has no ability to generate positive cash flows from operations. The Company is currently spending approximating \$175,000 more cash per month than it generates.

During the six months ended June 30, 2007, the Company received \$2,575,000 in proceeds from the Convertible Note offering and Preferred Series C offering. These proceeds were used for working capital and acquisitions. The Company estimates that it will need to raise an additional \$2,100,000 during the next 12 months to meet its minimum capital requirements. There is substantial doubt that the Company will be able to continue as a going concern, absent raising additional financing. There can be no assurance that the Company will be successful in obtaining the required financing.

28

The financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its obligations in the normal course of business. If the Company were not to continue as a going concern, it would likely not be able to realize its assets at values comparable to the carrying value or the fair value estimates reflected in the balances set out in the preparation of the consolidated financial statements.

The Company does not use financial instruments for trading purposes and is not a party to any leverage derivatives. To the extent that the Company has or continues to issue debt obligations outside of the course of its normal operations, the Company's business and results of operations may be materially affected by changes in interest rates and certain other credit risk associated with its operations.

### **Other Matters**

In the event the Company experiences substantial growth in the future, the Company's business and results of operations may be materially affected by changes in interest rates and certain other credit risk associated with its operations.

### **Off Balance Sheet Arrangements**

The Company has no off balance sheet financing arrangements that have or are reasonably likely to have a current or future affect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

## **ITEM 3. CONTROLS AND PROCEDURES.**

### **(a) Evaluation of Disclosure Controls and Procedures.**

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This term refers to the controls and procedures of a Company that are designed to ensure that information required to be disclosed by a Company in the reports that it files under the Exchange Act is recorded, processed, summarized, and reported within the required time periods. Our Chief Executive Officer and Principal Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report. They have concluded that, as of that date, our disclosure controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

### **(b) Changes in Internal Control over Financial Reporting.**

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II. Other Information****ITEM 1. LEGAL PROCEEDINGS.**

On July 5, 2007, the Company was served with a notice of charge of discrimination by a former independent sales representative (ISP) for alleged acts by another ISP. The claimant is seeking total monetary damages in the amount of \$150,000. The Company is awaiting a response from the United States Equal Opportunity Commission. The Company believes it has minimal or no liability as the Company is protected by indemnification provisions within the ISP agreements.

On July 19, 2007, the Company was sued in civil court by an individual for \$7,500 for anti-spam violations. The Company believes it had nothing to do whatsoever with the allegations in this summons of civil action.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

There were no unregistered sales of equity securities during the six months ended June 30, 2007 that have not been disclosed in reports on Form 8-K, except as set forth below.

The Company sold 91,666 of Preferred Series C shares totaling \$274,998 to five accredited investors during April 2007. Each Series C Share is convertible into ten shares of the Company's common stock (subject to certain anti-dilution adjustments) at any time at the holder's option. Each Series C Share will automatically be converted into ten shares of Common Stock (subject to certain anti-dilution provisions) upon (i) the affirmative vote of a majority of the outstanding shares of the Preferred Stock (voting together as a single class) or (ii) the consummation of an underwritten public offering with aggregate proceeds in excess of \$3,000,000.

In connection with the sale of the Series C Shares the Company relied upon the exemptions provided by Section 4(2) of the Securities Act of 1933 (the "Act"), and Rule 506 under the Act. The securities were sold to persons who were already shareholders of the Company as well as persons with whom Directors of the Company had a prior business relationship. The Company reasonably believes that all of these investors are "Accredited Investors," as defined under the Act, who had access to complete information concerning the Company. Each investor was given a private placement memorandum that provided detailed information about the Company and the securities to be issued, and investors were given an opportunity to ask questions of management. No advertising or other general solicitation was used in connection with the offering. The investors signed subscription documents representing that they were acquiring the securities for investment purposes only. A restrictive legend will be placed on the certificates representing the securities issued.

## 30

The Company sold 111,111 of Preferred Series C shares to four accredited investors totaling \$400,000 during June 2007. Each Series C Share is convertible into ten shares of the Company's common stock (subject to certain anti-dilution adjustments) at any time at the holder's option. Each Series C Share will automatically be converted into ten shares of Common Stock (subject to certain anti-dilution provisions) upon (i) the affirmative vote of a majority of the outstanding shares of the Preferred Stock (voting together as a single class) or (ii) the consummation of an underwritten public offering with aggregate proceeds in excess of \$3,000,000.

In connection with the sale of the Series C Shares the Company relied upon the exemptions provided by Section 4(2) of the Act, and Rule 506 under the Act. The securities were sold to persons who were already shareholders of the Company as well as persons with whom Directors of the Company had a prior business relationship. The Company reasonably believes that all of these investors are "Accredited Investors," as defined under the Act, who had access to complete information concerning the Company. Each investor was given a private placement memorandum that provided detailed information about the Company and the securities to be issued, and investors were given an opportunity to ask questions of management. No advertising or other general solicitation was used in connection with the offering. The investors signed subscription documents representing that they were acquiring the securities for investment purposes only. A restrictive legend will be placed on the certificates representing the securities issued.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

Not Applicable.

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

Not Applicable.

**ITEM 5. OTHER INFORMATION.**

Not Applicable

**ITEM 6. EXHIBITS.**

Exhibit No. -----	Description -----
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a).
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a).
32.1	Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

31

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**AMERICAN TONERSERV CORP.**

*Date: August 14, 2007*

*By:/s/ Daniel J. Brinker  
Daniel J. Brinker  
Chief Executive Officer*

*By:/s/ Ryan Vice  
Ryan Vice  
Chief Financial Officer*

32

SECTION 302 CERTIFICATION

I, Daniel J. Brinker, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of American TonerServ Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

*Date: August 14, 2007*

*/s/ Daniel J. Brinker  
Daniel J. Brinker  
Chief Executive Officer*

SECTION 302 CERTIFICATION

I, Ryan Vice, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of American TonerServ Corp.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the small business issuer and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

*Date: August 14, 2007*

*/s/ Ryan Vice  
Ryan Vice  
Chief Financial Officer*

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO**

**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Form 10-QSB of American TonerServ Corp., a company duly formed under the laws of Delaware (the "Company"), for the quarter ended June 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Daniel J. Brinker, Chief Executive Officer of the Company, hereby certifies, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of his/her knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

*August 14, 2007*

*/s/ Daniel J. Brinker  
Daniel J. Brinker  
Chief Executive Officer*

This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided to American TonerServ Corp. and will be retained by American TonerServ Corp. and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO**

**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Form 10-QSB of American TonerServ Corp., a company duly formed under the laws of Delaware (the "Company"), for the quarter ended June 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Ryan Vice, Principal Financial Officer of the Company, hereby certifies, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of his/her knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

*August 14, 2007*

*/s/ Ryan Vice  
Ryan Vice  
Principal Financial Officer*

This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided to American TonerServ Corp. and will be retained by American TonerServ Corp. and furnished to the Securities and Exchange Commission or its staff upon request.