

ICEWEB INC  
Form 10QSB  
February 14, 2007

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

**FORM 10-QSB**

(Mark One)

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

For the period ended December 31, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT

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

Commission file number: 0-27865

**ICEWEB, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**13-2640971**

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

**205 Van Buren Street, Suite 150  
Herndon, VA 20170**

(Address of principal executive offices)

**(703) 964-8000**

(Registrant's telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: At February 14, 2007, there were 9,777,909 outstanding shares of common stock, \$.001 par value per share.

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

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**CAUTIONARY STATEMENT REGARDING FORWARD LOOKING INFORMATION**

This quarterly report contains forward-looking statements. These forward-looking statements are subject to risks and uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from the results, performance or achievements expressed or implied by the forward-looking statements. You should not unduly rely on these statements. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe,” “project,” “contemplate,” “would,” “should,” “could,” or “may.” With respect to any forward-looking statement that includes a statement of its underlying assumptions or bases, we believe such assumptions or bases to be reasonable and have formed them in good faith, assumed facts or bases almost always vary from actual results, and the differences between assumed facts or bases and actual results can be material depending on the circumstances. When, in any forward-looking statement, we express an expectation or belief as to future results, that expectation or belief is expressed in good faith and is believed to have a reasonable basis, but there can be no assurance that the stated expectation or belief will result or be achieved or accomplished. All subsequent written and oral forward-looking statements attributable to us, or anyone acting on our behalf, are expressly qualified in their entirety by the cautionary statements.

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**ICEWEB, INC. AND SUBSIDIARIES**  
FORM 10-QSB  
QUARTERLY PERIOD ENDED December 31, 2006

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**IceWEB, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEET**  
**December 31, 2006**  
**(Unaudited)**

<b>CURRENT ASSETS:</b>	
Cash	\$ 288,901
Accounts receivable, net of allowance for bad debt of \$9,000	1,433,302
Prepaid expenses	7,287
<b>Total current assets</b>	<b>1,729,490</b>
<b>OTHER ASSETS:</b>	
Property and equipment, net	365,892
Goodwill	430,000
Deposits	53,956
Intangible assets, net of accumulated amortization of \$60,000	35,000
Deferred financing costs, net	155,000
<b>Total Assets</b>	<b>\$ 2,769,338</b>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>	
<b>CURRENT LIABILITIES:</b>	
Notes payable	\$ 1,242,811
Note payable - related party	181,599
Current portion of equipment financing payable	75,765
Accounts payable	1,529,424
Accrued expenses	322,977
Accrued interest payable	258,865
Advances from related party	19,860
<b>Total current liabilities</b>	<b>3,631,301</b>
<b>LONG-TERM LIABILITIES:</b>	
Equipment financing payable, net of current portion	168,149
Note payable - related party	150,000
<b>Total long-term liabilities</b>	<b>318,149</b>
<b>Total Liabilities</b>	<b>3,949,450</b>
<b>STOCKHOLDERS' DEFICIT:</b>	
Preferred stock (\$.001 par value; 10,000,000 shares authorized)	
Series A convertible preferred stock (\$.001 par value; 1,256,667 shares issued and outstanding)	1,257
Series B convertible preferred stock (\$.001 par value; 1,833,334 shares issued and outstanding)	1,833
Common stock (\$.001 par value; 1,000,000,000 shares authorized;	

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9,777,909 shares issued and 9,615,409 shares outstanding)	9,779
Additional paid-in capital	10,558,462
Accumulated deficit	(11,461,108)
Deferred compensation	(277,335)
Treasury stock, at cost, (162,500 shares)	(13,000)
Total Stockholders' Deficit	(1,180,112)
Total Liabilities and Stockholders' Deficit	\$ 2,769,338

See accompanying notes to unaudited consolidated financial statements

IceWEB, Inc. and Subsidiaries  
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended December 31,	
	2006 (Unaudited)	2005 (Unaudited)
Sales	\$ 2,581,777	\$ 1,491,216
Cost of sales	2,295,410	1,241,409
Gross profit	286,367	249,807
Operating expenses:		
Marketing and selling	60,216	47,189
Depreciation and amortization expense	65,541	19,371
General and administrative	760,366	513,987
Total operating expense	886,123	580,547
Loss from operations	(599,756)	(330,740)
Other income (expenses):		
Gain from sales of net assets	138,586	-
Interest income	1,309	-
Interest expense	(130,205)	(20,918)
Total other income (expenses):	9,690	(20,918)
Net loss	(590,066)	(351,658)
Beneficial conversion feature -preferred stock	-	(500,000)
Net loss attributable to common shareholders	\$ (590,066)	\$ (851,658)
Net loss per common share available to common shareholders:		
Basic and diluted loss per share	\$ (0.06)	\$ (0.13)
Weighted average common shares outstanding - basic and diluted	9,423,344	6,329,787

See accompanying notes to unaudited consolidated financial statements

IceWEB, Inc. and Subsidiaries  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Three Months Ended December 31,	
	2006 (Unaudited)	2005 (Unaudited)
<b>CASH FLOWS FROM OPERATIONS:</b>		
Net Loss	\$ (590,066)	\$ (351,658)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	65,541	9,371
Stock-based compensation	158,635	-
Gain on sales of net assets	(138,586)	-
Amortization of deferred finance costs	4,999	5,000
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(223,846)	(325,335)
Prepaid expense	2,384	(50,271)
Advances	-	(975)
Deposits	(860)	(16,855)
Increase (decrease) in:		
Accounts payable	821,829	238,734
Accrued expense	(456,567)	53,441
Accrued interest payable	4,687	4,687
Deferred revenue	(39,156)	(1,075)
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(391,006)</b>	<b>(434,936)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(1,874)	(79,218)
Net cash received from sale of net assets	138,000	-
Cash used in acquisitions, net	(250,000)	-
Capitalized software	-	(160,773)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(113,874)</b>	<b>(239,991)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of equipment financing	(18,382)	-
Proceeds from notes payable - related party	30,000	6,521
Repayment of notes payable - related party	(26,500)	-
Net proceeds from related party advances	11,737	-
Proceeds from bank financing	-	339,476
Payment of placement fees and expenses	-	(46,398)
Proceeds from notes payable	242,041	-
Payments on notes payable	(200,000)	-
Proceeds from exercise of common stock options	35,000	-
Proceeds from exercise of common stock warrants	287,000	-



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NET CASH PROVIDED BY FINANCING ACTIVITIES	360,896	299,599
NET DECREASE IN CASH	(143,984)	(375,328)
CASH - beginning of year	432,885	557,175
CASH - end of period	\$ 288,901	\$ 181,847
Supplemental disclosure of cash flow information:		
Cash paid for :		
Interest	\$ 125,518	\$ 20,918
Income taxes	\$ -	\$ -

NON-CASH INVESTING AND FINANCING ACTIVITIES:

Acquisition details:		
Goodwill	\$ 430,000	\$ -
Liabilities assumed	\$ 180,000	\$ -
Cash paid	\$ 250,000	\$ -

See accompanying notes to unaudited consolidated financial statements

ICEWEB, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(Unaudited)

**NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**The Company**

IceWEB, Inc. (the "Company") began trading publicly in April 2002. In June 2003, the Company added two subsidiaries, acquiring all of the outstanding stock of Interlan Communications Incorporated and The Seven Corporation. Interlan is a full service provider of computer equipment and integration services. The Seven Corporation provides network engineering services. On October 5, 2003, the Company acquired the software ownership rights and customers of Iplicity, Inc. of Virginia. Iplicity had developed a complete content management software platform based on open source architecture to run in any operating environment. Utilizing resources gained through acquisitions, the Company has developed two applications that are now available to the general public, IceWEB Vista which is a website portal development and management application, and IceMAIL which is a hosted Microsoft Exchange application service. In addition to the new application services, the Company also continues to provide customers with systems integration, network consulting, and customized software application services.

Complementing the online service offerings is the Company's IceWEB Solutions Group. The IceWEB Solutions Group focuses on providing computer network security products such as access control, content filtering, email security, intrusion detection, and the latest layer 7 firewall technology. IceWEB has certified technical and sales personnel who continuously build and maintain excellent relationships with key manufacturers of network security solutions. The combination of its vendor partners/manufacturers, customers, and Government contracting vehicles enables IceWEB to be successful in providing the industry's best network security solutions to the Federal Government and commercial integrators who service the Government.

On October 31, 2006, the Company entered into an Asset Purchase Agreement (the "Agreement") with True North Solutions, Inc., a Delaware corporation ("True North") whereby the Company acquired all or substantially all of True North's assets used in its Government Business Company (see note 3).

**Basis of presentation**

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The accompanying consolidated financial statements for the interim periods are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the periods presented. The consolidated financial statements include the accounts of the Company and its wholly and partially owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. These consolidated financial statements should be read in conjunction with the financial statements for the year ended September 30, 2006 and notes thereto contained on Form 10-KSB of the Company as filed with the Securities and Exchange Commission. The results of operations for the three months ended December 31, 2006 are not necessarily indicative of the results for the full fiscal year ending September 30, 2007.

ICEWEB, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(Unaudited)

**NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continued)**

**Going Concern**

The Company's auditors stated in their report on the consolidated financial statements of the Company for the years ended September 30, 2006 and 2005 that the Company is dependent on outside financing and has had losses since inception that raise doubt about its ability to continue as a going concern. For the three months ended December 31, 2006, the Company incurred a net loss of \$590,066 and used cash in operations of \$391,006. The consolidated financial statements do not include any adjustments related to the recovery and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the Company cannot continue in existence.

Management has established plans intended to increase the sales of the Company's products and services. Management intends to seek new capital from new equity securities offerings to provide funds needed to increase liquidity, fund growth, and implement its business plan. However, no assurances can be given that the Company will be able to raise any additional funds.

**Use of estimates**

The preparation of financial statements in conformity with generally accepted accounting principles 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. Significant estimates in 2007 and 2006 include the allowance for doubtful accounts, the valuation of stock-based compensation, the useful life of property and equipment, and the valuation of goodwill.

**Cash and Cash Equivalents**

The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

**Accounts Receivable**

Accounts receivable consists of normal trade receivables. The Company recorded a bad debt allowance of \$9,000 as of December 31, 2006. Management performs ongoing evaluations of its accounts receivable. Management believes that all remaining receivables are fully collectable. Bad debt expense amounted to \$0 and \$0 for the three months ended December 31, 2006 and 2005, respectively.

**Intangible Assets**

Intangible assets, net consists of the cost of acquired customer relationships. The Company capitalizes and amortizes the cost of acquired intangible assets over their estimated useful lives on a straight-line basis. The estimated useful lives of the Company's acquired customer relationships is five years.



ICEWEB, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(Unaudited)

**NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continued)**

**Property and Equipment**

Property and equipment is stated at cost, net of accumulated depreciation. Depreciation is provided by using the straight-line method over the estimated useful lives of the related assets.

Property and equipment also includes costs incurred in connection with development on the Company's software developed for internal use and website costs. The Company capitalized certain costs valued in connection with developing or obtaining internal use software in accordance with American Institute of Certified Public Accountants Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use". These costs, which consist of direct technology labor costs, are capitalized and amortized using the straight-line method over expected useful lives of three years.

**Goodwill**

Goodwill is recorded on a business combination to the extent the cost of an acquired entity exceeds the fair value of the net assets acquired.

The Company does not amortize goodwill but tests goodwill impairment at least on an annual basis, or earlier when events or changes in circumstances suggest the carrying amount may not be fully recoverable. Such evaluation is performed by comparing the implied fair value of a reporting unit to its carrying value, including goodwill. An impairment loss is recognized in the current period if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value. The Company performed its latest annual impairment test with regard to the carrying value of goodwill as of December 31, 2006. For the three months ended December 31, 2006, the Company did not record any impairment to goodwill.

**Long-lived Assets**

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company reviews the carrying value of intangibles and other long-lived assets for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is measured by comparison of its carrying amount to the undiscounted cash flows that the asset or asset group is expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the property, if any, exceeds its fair market value.

ICEWEB, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(Unaudited)

**NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(continued)**

**Revenue Recognition**

The Company follows the guidance of the Securities and Exchange Commission's Staff Accounting Bulletin 104 for revenue recognition. In general, the Company records revenue when persuasive evidence of an arrangement exists, services have been rendered or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured. The following policies reflect specific criteria for the various revenues streams of the Company:

Revenues from sales of products are generally recognized when products are shipped unless the Company has obligations remaining under sales or licensing agreements, in which case revenue is either deferred until all obligations are satisfied or recognized ratably over the term of the contract.

Revenue from services is recorded as it is earned. Commissions earned on third party sales are recorded in the month in which contracts are awarded. Customers are generally billed every two weeks based on the units of production for the project. Each project has an estimated total which is based on the estimated units of production and agreed upon billing rates. Amounts billed in advance of services being provided are recorded as deferred revenues and recognized in the consolidated statement of operations as services are provided.

**Earnings per Share**

The Company computes earnings per share in accordance with Statement of Accounting Standards No. 128, "Earnings per Share ("SFAS No. 128"). Under the provisions of SFAS No. 128, basic earnings per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing the net income (loss) for the period by the weighted average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of the common shares issuable upon the exercise of stock options and warrants (using the treasury stock method) and upon the conversion of convertible preferred stock (using the if-converted method). Potentially dilutive common shares are excluded from the calculation if their effect is anti-dilutive. At December 31, 2006, there were options and warrants to purchase 7,759,032 shares of common stock and 3,090,001 shares issuable upon conversion of Series A and B preferred stock which could potentially dilute future earnings per share.

**Stock-Based Compensation**

Prior to October 1, 2006, the Company accounted for stock options issued under the Plan under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation* ("SFAS No. 123").

ICEWEB, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(Unaudited)

**NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
(Continued)**

**Stock-based compensation (continued)**

Effective October 1, 2005, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment*, using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the three months ended December 31, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R).

**Recent Accounting Pronouncements**

In February 2006, the FASB issued SFAS 155, which applies to certain "hybrid financial instruments," which are instruments that contain embedded derivatives. The new standard establishes a requirement to evaluate beneficial interests in securitized financial assets to determine if the interests represent freestanding derivatives or are hybrid financial instruments containing embedded derivatives requiring bifurcation. This new standard also permits an election for fair value remeasurement of any hybrid financial instrument containing an embedded derivative that otherwise would require bifurcation under SFAS 133. The fair value election can be applied on an instrument-by-instrument basis to existing instruments at the date of adoption and can be applied to new instruments on a prospective basis. The adoption of SFAS No.155 did not have a material impact on the Company's financial position and results of operations.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". This statement requires all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable, and permits for subsequent measurement using either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of Statement No. 140. The subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value eliminates the necessity for entities that manage the risks inherent in servicing assets and servicing liabilities with derivatives to qualify for hedge accounting treatment and eliminates the characterization of declines in fair value as impairments or direct write-downs. SFAS No. 156 is effective for an entity's first fiscal year beginning after September 15, 2006. The adoption of this statement is not expected to have a significant effect on the Company's future reported financial position or results of operations.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109." This interpretation provides guidance for recognizing and measuring uncertain tax positions, as defined in SFAS No. 109, "Accounting for Income Taxes." FIN No. 48 prescribes a threshold condition that a tax position must meet for any of the benefit of an uncertain tax position to be recognized in the financial statements. Guidance is also provided regarding de-recognition, classification, and disclosure of uncertain tax positions. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect that this interpretation will have a material impact on its financial position, results of operations, or cash flows.





ICEWEB, INC. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
 December 31, 2006  
 (Unaudited)

**NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
 (Continued)**

**Recent Accounting Pronouncements (continued)**

In September 2006, the U.S. Securities and Exchange Commission (SEC) released Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," (SAB No. 108) which provides interpretive guidance on the SEC's views regarding the process of quantifying materiality of financial statement misstatements. SAB No. 108 is effective for years ending after November 15, 2006, with early application for the first interim period ending after November 15, 2006. The Company does not believe that the application of SAB No. 108 will have a material effect on the Company's results of operations or financial position.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"). This Statement defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosure related to the use of fair value measures in financial statements. The Statement is to be effective for the Company's financial statements issued in 2008; however, earlier application is encouraged. The Company is currently evaluating the timing of adoption and the impact that adoption might have on its financial position or results of operations

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

**NOTE 2 - PROPERTY AND EQUIPMENT**

At December 31, 2006, property and equipment consisted of the following:

	Estimated Life	
Office equipment	5 years	\$ 176,840
Computer software	3 years	674,139
Furniture and fixtures	5 years	30,133
Leasehold improvements	3 years	4,553
		885,665
Less: accumulated depreciation		(519,773)
		\$ 365,892

Depreciation expense for the three months ended December 31, 2006 and 2005 was \$60,541 and \$9,371 respectively.

ICEWEB, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(Unaudited)

**NOTE 3 - ACQUISITION AND DISPOSITIONS**

On March 22, 2006, the Company acquired certain assets and liabilities of PatriotNet, Inc. a professional Internet Service Provider (ISP) servicing over 3,500 customers with T-1, DSL, dial up lines and email services. In consideration for the purchase of the net assets and liabilities including accounts receivable, equipment and intangibles for customer contracts, the Company paid to PatriotNet (a non-related party to the Company) (a) the payment of cash consideration to PatriotNet of \$190,000 at Closing and (b) the issuance by the Company of 100,000 (restricted under Rule 144) shares of its common stock at Closing, valued at \$1.00 dollar per share of \$100,000. The Company accounted for this acquisition using the purchase method of accounting in accordance with SFAS No. 141. On the date of acquisition, the purchase price exceeded the fair value of net assets by \$390,600 which was applied to goodwill. In fiscal 2006, the Company recorded an impairment of goodwill of \$180,000 which was charged to operations in fiscal 2006. In November 2006, the Company sold PatriotNet to a third party for \$150,000 in cash and the assumption of approximately \$60,600 in liabilities by the purchaser. No gain or loss was recognized on the sale.

In November 2006, the Company sold its interest in one of its subsidiaries (Integrated Power Solutions, Inc. or IPS) to a shareholder of the Company and related party for the payment of cash to the third party of \$12,000, the assignment to the purchaser of accounts receivable of \$54,609, and assumption by the purchaser of approximately \$205,200 in accounts payable. In connection with this sale, the Company recorded a gain of \$138,586.

On October 31, 2006, the Company entered into an Asset Purchase Agreement (the "Agreement") with True North Solutions, Inc., a Delaware corporation ("True North") whereby the Company acquired all or substantially all of True North's assets used in its Government Business. Upon the terms and subject to the conditions of the Agreement, the Company agreed to purchase, accept, and acquire from True North all right, title, and interest of True North in and to the Government Business, which is hereby defined and limited to (i) certain vendor agreements and (ii) all of those rights and assets, tangible or intangible, exclusively used in the performance of day to day business operations, as owned or held True North such as certain tangible assets, websites, databases, GSA schedules and other government contracts, Federal client lists, and contracts in progress. The aggregate purchase price for these assets was \$430,000 of which \$250,000 was paid in cash at closing and the balance shall be evidenced by a promissory note secured by collateral pledge of the assets, payable immediately upon accomplishment of the novation of the GSA Schedule. Additionally the Company accrued \$80,000 in finder's fees payable in connection with this acquisition. The Company accounted for this acquisition using the purchase method of accounting in accordance with SFAS No. 141. On the date of acquisition, the purchase price exceeded the fair value of net assets by \$430,000 which was applied to goodwill. The Company is currently analyzing this acquisition and may reclassify a portion of this goodwill to amortizable intangible assets.

ICEWEB, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2006  
(Unaudited)

**NOTE 4 - RELATED PARTY TRANSACTIONS**

Note Payable - Related Party

During June to October 2006, a company that the Company's chief executive officer is a shareholder in lent funds to the Company for working capital purposes. The loan was due no later than 30 days from that date of funding. As consideration for providing the funding, the Company agreed to issue 1.54 shares of common stock for each dollar lent under the loan. During the three months ended December 31, 2006, the Company borrowed \$30,000 under this loan agreement and repaid approximately \$26,500. At December 31, 2006, the Company owed this related party \$181,599. Additionally, the related party is due 339,606 common shares under the loan agreement. In October 2006, the related party company waived any further common shares on funds received subsequent to September 30, 2006. At December 31, 2006, in connection with the common shares due under this agreement, the Company has reflected an accrued interest payable of \$169,803 on the accompanying consolidated balance sheet.

Note Payable - Related Party - Long-term

At December 31, 2006, the Company owed \$150,000 of principal under a promissory note to a shareholder of the Company. The note bears interest at the rate of 12.5% per annum and was due on demand. In May 2005, the Company issued to this stockholder 125,000 shares of common stock as consideration for the extension of the maturity date of the note by 10 years to September 30, 2014 which had been orally agreed to in fiscal 2004. The shares were valued at \$200,000, the fair value at the date of issuance. The cost associated with these shares has been accounted for as deferred finance charges, and is being amortized over the life of the deferral period. For the three months ended December 31, 2006 and 2005, amortization of deferred financing costs amounted to \$4,999 and \$5,000, respectively, and is included in interest expense on the accompanying consolidated statements of operation. The note remains outstanding and at December 31, 2006, the Company owed the stockholder the \$150,000 principal plus accrued interest of approximately \$89,062.

Advances from Related Party

The Company's Chief Executive Officer provides advances to the Company from time-to-time for operating expenses. These advances are short-term in nature and are non-interest bearing. At December 31, 2006, amounts due to this related party amounted to \$19,860.

ICEWEB, INC. AND SUBSIDIARIES  
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**NOTE 5 - NOTES PAYABLE**

Sand Hill Finance, LLC

On December 19, 2005, the Company entered into a Financing Agreement with Sand Hill Finance, LLC pursuant to which, together with related amendments, the Company may borrow up to 80% on the Company's accounts receivable balances up to a maximum of \$1,800,000. Amounts borrowed under the Financing Agreement are secured by a first security interest in substantially all of the Company's assets. At December 31, 2006, the principal amount due under the Financing Agreement amounted to \$1,242,811.

Interest is payable at a rate of 2% per month on the average balance outstanding during the year, equal to an annual interest of approximately 24% per year. The Company also agreed to pay an upfront commitment fee of 1% of the credit line upon signing of the Financing Agreement, half of which was due and paid upon signing (amounting to \$9,000) and half of which is due on the first anniversary of the Financing Agreement. In addition, the Company is obligated to pay a commitment fee of 1% of the credit limit annually, such amount payable on the anniversary of the agreement.

The Financing Agreement contains a number of positive and negative covenants, including a requirement for the Company to provide monthly unaudited financial statements within 20 days of each month-end and audited financial statements together with an accountant's opinion within 90 days of the end of each fiscal year.

The Financing Agreement has a term of one year, subject to mutual extension by both parties. As a result, the balance due to Sand Hill Finance, LLC is classified as a current liability on the accompanying consolidated balance sheet.

The terms of the Financing Agreement also restrict the Company from undertaking certain transactions without the written consent of the creditor including (i) permit or suffer a change in control involving 20% of its securities, (ii) acquire assets, except in the ordinary course of business, involving payment of \$100,000 or less, (iii) sell, lease, or transfer any of its property except for sales of inventory and equipment in the ordinary course of business, (iv) transfer, sell or license any intellectual property, (v) declare or pay a dividend on stock, except payable in the form of stock dividends (vi) incur any indebtedness other than trade credit in the ordinary course of business and (vii) permit any lien or security interest to attach to any collateral.

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**NOTE 5 - NOTES PAYABLE (Continued)**

Note Payable - Other

On September 29, 2006, the Company borrowed \$200,000 from a shareholder. The note was payable on October 29, 2006 and bears interest at 12% per annum. The Company repaid this loan in October 2006.

**NOTE 6 - EQUIPMENT FINANCING PAYABLE**

On July 6, 2006, the Company entered into what is in essence a sale and leaseback agreement with respect to certain computer and office equipment. The Company received gross proceeds of \$300,000 from the sale of the equipment to a third party. As part of the same transaction, the Company entered into an agreement to lease the equipment back from the third party for 36 monthly rent payments of \$10,398 until August 2009. The Company accounted for this equipment financing arrangement as a capital lease. In connection with the agreement, the Company made an initial security deposit of \$30,000 and is included in deposits in the balance sheet at December 31, 2006. The equipment had a net book value of \$37,846 on the date of the transaction. In connection with the financing, the Company did not record any gain or loss. Imputed interest on this financing is 20% per annum. At December 31, 2006, the principal amount due under this equipment financing arrangement amounted to \$243,914.

**NOTE 7 - CONCENTRATION OF CREDIT RISK**

Bank Balances

The Company maintains its cash bank deposits at various financial institutions which, at times, may exceed federally insured limits. Accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000. At December 31, 2006, the Company had approximately \$135,000 in excess of FDIC insured limits. The Company has not experienced any losses in such accounts.

Major Customers

Sales to two customers represented approximately 21% of total sales for the three months ended December 31, 2006. As of December 31, 2006, approximately 42% of the Company's accounts receivable was due from these two customers.

**NOTE 8 - STOCKHOLDERS' DEFICIT**

**Common stock**

During November 2006, in connection with the exercise of 820,000 stock warrants, the Company issued 820,000 shares of common stock for cash proceeds of \$287,000.

During November 2006, in connection with the exercise of 100,000 stock options, the Company issued 100,000 shares of common stock for cash proceeds of \$35,000.



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**NOTE 8 - STOCKHOLDERS' DEFICIT (continued)****Common Stock Warrants**

A summary of the status of the Company's outstanding common stock warrants as of December 31, 2006 and changes during the period ending on that date is as follows:

	Number of Warrants	Weighted Average Exercise Price
<b>Common Stock Warrants</b>		
Balance at beginning of year	7,055,000	\$ 4.88
Granted	-	-
Exercised	(820,000)	0.35
Forfeited	-	-
Balance at end of period	6,235,000	\$ 5.45
Warrants exercisable at end of period	6,235,000	\$ 5.45
Weighted average fair value of warrants granted or re-priced during the period		\$ 0.35

The following table summarizes information about common stock warrants outstanding at December 31, 2006:

Range of Exercise Price	Warrants Outstanding			Warrants Exercisable		
	Number Outstanding at December 31, 2006	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at December 31, 2006	Weighted Average Exercise Price	
\$ 0.70	175,000	3.25 Years	\$ 0.70	175,000	\$ 0.70	
1.00	50,000	4.95 Years	1.00	50,000	1.00	
2.00	1,785,000	3.75 Years	2.00	1,785,000	2.00	
4.00	187,500	1.00 Years	4.00	187,500	4.00	
4.80	1,875,000	3.50 Years	4.80	1,875,000	4.80	
8.00	287,500	3.00 Years	8.00	287,500	8.00	
9.60	1,875,000	3.50 Years	9.60	1,875,000	9.60	
	6,235,000		\$ 5.45	6,235,000	\$ 5.45	

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**NOTE 9 - STOCK OPTION PLAN**

In August 2000, the Board of Directors adopted the 2000 Management and Director Equity Incentive and Compensation Plan the "Plan") for directors, officers and employees that provides for non-qualified and incentive stock options to be issued enabling holders thereof to purchase common shares of the Company at exercise prices determined by the Company's Board of Directors. The Plan was approved by the Company's stockholders in August 2001.

The purpose of the Plan is to advance the Company's interests and those of its stockholders by providing a means of attracting and retaining key employees, directors and consultants. In order to serve this purpose, the Company believes the Plan encourages and enables key employees, directors and consultants to participate in its future prosperity and growth by providing them with incentives and compensation based on its performance, development and financial success. Participants in the Plan may include the Company's officers, directors, other key employees and consultants who have responsibilities affecting our management, development or financial success.

Awards may be made under the Plan in the form of Plan options, shares of the Company's common stock subject to a vesting schedule based upon certain performance objectives ("Performance Shares") and shares subject to a vesting schedule based on the recipient's continued employment ("restricted shares"). Plan options may either be options qualifying as incentive stock options under Section 422 of the Internal Revenue Code of 1986, as amended or options that do not so qualify. Any incentive stock option granted under the Plan must provide for an exercise price of not less than 100% of the fair market value of the underlying shares on the date of such grant, but the exercise price of any incentive option granted to an eligible employee owning more than 10% of our common stock must be at least 110% of such fair market value as determined on the date of the grant. Only persons who are officers or other key employees are eligible to receive incentive stock options and performance share grants. Any non-qualified stock option granted under the Plan must provide for an exercise price of not less than 50% of the fair market value of the underlying shares on the date of such grant.

As amended in fiscal 2006, the Plan permits the grant of options and shares for up to 2,500,000 shares of the Company's common stock. The Plan terminates 10 years from the date of the Plan's adoption by the Company's stockholders.

The term of each Plan option and the manner in which it may be exercised is determined by the Board of Directors, provided that no Plan option may be exercisable more than three years after the date of its grant and, in the case of an incentive option granted to an eligible employee owning more than 10% of the Company's common stock, no more than five years after the date of the grant. The exercise price of the stock options may be paid in either cash, or delivery of unrestricted shares of common stock having a fair market value on the date of delivery equal to the exercise price, or surrender of shares of common stock subject to the stock option which has a fair market value equal to the total exercise price at the time of exercise, or a combination of the foregoing methods.



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**NOTE 9 - STOCK OPTION PLAN (continued)**

The fair value of stock options granted was estimated at the date of grant using the Black-Scholes options pricing model. The Company used the following assumptions for determining the fair value of options granted under the Black-Scholes option pricing model:

	December 31,	
	2006	2005
Expected volatility	116% - 135%	111%
Expected term	5 Years	5 years
Risk-free interest rate	4.39% - 4.56%	4%
Expected dividend yield	0%	0%

The expected volatility was determined with reference to the historical volatility of the Company's stock. The Company uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted represents the period of time that options granted are expected to be outstanding. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury rate in effect at the time of grant.

For the three months ended December 31, 2006, total stock-based compensation charged to operations for option-based arrangements amounted to \$88,385. At December 31, 2006, there was approximately \$182,500 or total unrecognized compensation expense related to non-vested option-based compensation arrangements under the Plan.

A summary of the status of the Company's outstanding stock options as of December 31, 2006 and changes during the period ending on that date is as follows:

	Number of Options	Weighted Average Exercise Price
<u>Stock options</u>		
Balance at beginning of year	1,493,806	\$ 1.00
Granted	315,000	0.42
Exercised	(100,000)	0.35
Forfeited	(184,774)	2.00
Balance at end of period	1,524,032	\$ 0.80
Options exercisable at end of period	893,920	\$ .98
Weighted average fair value of options granted during the year		\$ 0.42

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**NOTE 9 - STOCK OPTION PLAN (continued)**

The following table summarizes information about employee stock options outstanding at December 31, 2006:

Range of Exercise Price	Options Outstanding			Options Exercisable		
	Number Outstanding at December 31, 2006	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at December 31, 2006	Weighted Average Exercise Price	
\$ 0.47-0.54	590,000	4.62 Years	\$ 0.47	119,476	\$ 0.47	
0.65-0.88	769,375	3.25 Years	0.73	618,662	0.73	
1.20-1.60	89,157	1.17 Years	1.51	80,282	1.30	
3.20-3.80	75,500	1.76 Years	3.21	75,500	3.20	
	1,524,032		\$ 0.80	893,920	\$ 0.98	

**NOTE 11 - SEGMENT REPORTING**

SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, establishes standards for the reporting by business enterprises of information about operating segments, products and services, geographic areas, and major customers. The method for determining what information to report is based on the way that management organizes the operating segments with IceWEB for making operational decisions and assessments of financial performance.

IceWEB's chief operating decision-maker is considered to be the chief executive officer (CEO). The CEO reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance. The financial information reviewed by the CEO is identical to the information presented in the accompanying consolidated statements of operations. For the three months ended December 31, 2006 and 2005 all material assets and revenues of IceWEB were in the United States.

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

The following analysis of our consolidated financial condition and results of operations for the three months ended December 31, 2006 and 2005, should be read in conjunction with the consolidated financial statements, including footnotes, and other information presented in our Form 10-KSB for the year ended September 30, 2006 as filed with the Securities and Exchange Commission.

### OVERVIEW

We provide hosted web-based collaboration solutions that enable organizations to establish Internet, Intranet, and email/collaboration services immediately and with little or no up-front capital investment. Our portal and IceMAIL collaboration software services are available on a monthly or annual subscription basis to small and medium-sized businesses and non-profit and government organizations. We also provide consulting services to our larger enterprise and government customers including network infrastructure, enterprise email/collaboration, and Internet/Intranet portal implementation and support services. We offer pre-packaged and custom services, using proven best practices to help organizations define their online business objectives and quickly deploy their Internet, Intranet, and email/collaboration systems. Although most of our small to medium-sized business customers purchase and activate our solutions online, our professional services teams work closely with our government, non-profit and larger customers to deploy customized solutions. We also market an array of information technology services and third party computer hardware and software.

Our history and acquisition strategy has been key in our growth as a company. We began as a full service provider of computer systems and professional services to private sector corporations and to the federal government under a General Services Administration (GSA) schedule contract for computer systems and peripherals. Beginning in 2001, we began a series of strategic acquisitions which have resulted in our current business and operations, including:

- In June 2001, we acquired the assets of Learning Stream, Inc., a provider of digital content streaming services, which coincided with the transition of our business model to a focus on e-learning. Learning Stream had developed custom streaming solutions which we believed were more efficient and effective than the solutions we had implemented at that time. We considered the software we acquired to be competitive because it helped remove the complexity and unnecessary cost from the implementation of the streaming technology,
- In June 2003, we acquired all of the outstanding stock of Interlan Corporation, a provider of data communications and networking solutions for business, government, and education. Interlan provided technical services including presales design and consulting, installation, troubleshooting, and long term maintenance and support contracts,
  - In June 2003, we also acquired all of the outstanding stock of The Seven Corporation, a provider of network engineering services to commercial and government customers throughout the United States,
- In October 2003, we acquired the software ownership rights and customers of Iplicity, Inc. of Virginia. Iplicity had developed a complete content management software platform based on open source architecture to run in any operating environment. In this transaction we acquired software licenses, source code, potential patents and trademarks,

**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)**

- In May 2004 we acquired substantially all of the assets of DevElements, Inc. of Virginia, a professional IT consultancy firm that designs, develops and implements web-based productivity solutions for the customers. In this transaction we acquired software licenses, source code, potential patents and trademarks, as well as some cash and tangible assets.
- In March 2006, the Company, through its wholly-owned subsidiary, IceWEB Online, Inc., completed the acquisition of substantially all of the assets and some liabilities of PatriotNet, Inc. This brought over 3000 customers with recurring subscription-based services into IceWEB. IceWEB has consolidated customer service and technical personnel to improve overall operational efficiencies within the company. In November 2006, we sold our interest in PatriotNet.
- In October 2006, we entered into an Asset Purchase Agreement (the "Agreement") with True North Solutions, Inc., a Delaware corporation ("True North") whereby we acquired all or substantially all of True North's assets used in its Government Business. Upon the terms and subject to the conditions of the Agreement, we agreed to purchase, accept, and acquire from True North all right, title, and interest of True North in and to the Government Business, which is hereby defined and limited to (i) certain vendor agreements and (ii) all of those rights and assets, tangible or intangible, exclusively used in the performance of day to day business operations, as owned or held True North such as certain tangible assets, websites, databases, GSA schedules and other government contracts, Federal client lists, and contracts in progress. We are currently integrating the operations of True North into our operations. To date, we have generated minimal revenue from this acquisition.

We generate revenues from sales of software licenses and provision of software application services, application development and network management services and integrated technology, infrastructure solutions and third party hardware sales. We anticipate that both revenues and expenses will to increase in future periods.

We believe that the key factors to our continued growth and profitability include the following:

We generate revenues from sales of software services, application development, network integrated technology, and third party hardware sales. We believe that the key factors to our continued growth and profitability include the following:

- 1 Further marketing of IceMAIL, a packaged service that provides a network-hosted groupware, email, calendaring, and collaboration solution utilizing Microsoft Exchange, the most widely used enterprise system available. Customers are able to leverage the full capabilities of Microsoft Exchange 2003 and Outlook without the initial implementation and maintenance costs associated with such an advanced system.

- 1 Continued focus on developing strategic partnerships with key retail and small business solution providers such as CompUSA, Simply Wireless, and Intelligent Office--all of which entered into sales and marketing agreements with IceWEB during fiscal 2006.
- 1 Continued growth in network security sales to existing Federal customers of the former True North Federal solutions.
- 1 Raising approximately \$4 million of additional working capital through the sale of warrants to expand our marketing, research and development, and refined our debt.
- 1 Hiring additional qualified, technical employees, and
- 1 Improving our internal financial reporting systems and processes.

We face continuing difficulties in locating sufficient qualified technical personnel. Our company is located in the "Tech Corridor" of Northern Virginia and we compete with a number of companies for employees, many of which have been in business longer than we have and which are more attractive to prospective employees. Our inability to accomplish one or more of these key goals may limit our growth in future periods.

#### **CRITICAL ACCOUNTING POLICIES**

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

A summary of significant accounting policies is included in Note 1 to the audited consolidated financial statements included for the year ended September 30, 2006 and notes thereto contained on Form 10-KSB of the Company as filed with the Securities and Exchange Commission. Management believes that the application of these policies on a consistent basis enables us to provide useful and reliable financial information about the company's operating results and financial condition.

**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)**

Financial Reporting Release No. 60, which was released by the U.S. Securities and Exchange Commission, encourages all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Our consolidated financial statements include a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. Management believes the following critical accounting policies affect the significant judgments and estimates used in the preparation of the financial statements.

Use of Estimates - Management's Discussion and Analysis or Plan of Operations is based upon our unaudited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates these estimates, including those related to allowances for doubtful accounts receivable, the carrying value of property and equipment and long-lived assets, and the value of stock-option based compensation. Management bases these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis of making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Accounting for Stock Based Compensation - Effective October 1, 2005, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share Based Payment* ("SFAS No. 123R"). SFAS No. 123R establishes the financial accounting and reporting standards for stock-based compensation plans. As required by SFAS No. 123R, we recognize the cost resulting from all stock-based payment transactions including shares issued under our stock option plans in the financial statements. The adoption of SFAS No. 123R will have a negative impact on our future results of operations.

Revenue Recognition - The Company follows the guidance of the Securities and Exchange Commission's Staff Accounting Bulletin 104 for revenue recognition. In general, the Company records revenue when persuasive evidence of an arrangement exists, services have been rendered or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured. The following policies reflect specific criteria for the various revenues streams of the Company:

Revenues from sales of products are generally recognized when products are shipped unless the Company has obligations remaining under sales or licensing agreements, in which case revenue is either deferred until all obligations are satisfied or recognized ratably over the term of the contract.

Revenue from services is recorded as it is earned. Commissions earned on third party sales are recorded in the month in which contracts are awarded. Customers are generally billed every two weeks based on the units of production for the project. Each project has an estimated total which is based on the estimated units of production and agreed upon billing rates.

Amounts billed in advance of services being provided are recorded as deferred revenues and recognized in the consolidated statement of operations as services are provided.

**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)****RESULTS OF OPERATIONS****THREE MONTHS ENDED DECEMBER 31, 2006 COMPARED THE THREE MONTHS ENDED DECEMBER 31, 2005**

The following table provides an overview of certain key factors of our results of operations for the three months ended December 31, 2006 as compared to the three months ended December 31, 2005:

	2006	2005	\$ Change	% Change
Net Revenues	\$ 2,581,777	\$ 1,491,216	\$ 1,090,561	73%
Cost of sales	2,295,410	1,241,409	1,054,001	85%
<b>Operating Expenses:</b>				
Marketing and selling	60,216	47,189	13,027	28%
Depreciation and amortization	65,541	19,371	46,170	238%
General and administrative	760,366	513,987	246,379	48%
Total operating expenses	886,123	580,547	305,576	53%
Loss from operation	(599,756)	(330,740)	269,016	81%
Total other income (expense)	9,690	(20,918)	30,608	146%
Net loss	(590,066)	(351,658)	238,408	68%
Beneficial conversion feature- Preferred Stock	-	(500,000)	500,000	(100)%
Net loss attributable to common Shareholders	\$ (590,066)	\$ (851,658)	\$ (261,592)	(31)%

**Revenues**

For the three months ended December 31, 2006, we reported revenues of \$2,581,777 as compared to revenues of \$1,491,216 for the prior three months ended December 31, 2005, an increase of \$1,090,561 or approximately 73%. The increase is primarily due to an increase in sales of our third party product sales which accounted for approximately 49% of our revenue and service income from primarily our custom development services which accounted for 51% of our revenue.

**Cost of Sales**

Our cost of sales consists of products purchased for resale, salaries of technical personnel, and third party contractors. For the three months ended December 31, 2006, cost of sales was \$2,295,410, or approximately 89% of revenues, compared to \$1,241,409, or approximately 83.2% of revenues, for the three months ended December 31, 2005. The increase in costs of sales as a percentage of revenue and the corresponding decrease in our gross profit margin for the three months ended December 31, 2006 as compared to the three months ended December 31, 2005 was the result of an increase during the three months ended December 31, 2006 in infrastructure and hardware revenues as a percentage of total revenue compared to infrastructure and hardware revenue in the previous period.

**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)*****Total Operating Expenses***

Our total operating expenses increased approximately 53% to \$886,123 for the three months ended December 31, 2006 as compared to \$580,547 for the three months ended December 31, 2005. These increases include:

**Marketing and Selling.** For the three months ended December 31, 2006, marketing and selling costs were \$60,216 as compared to \$47,189 for the three months ended December 31, 2005, an increase of \$13,027 or approximately 28%. The increases were the result of an increase in online web marketing, advertising and print advertising during the three months ended December 31, 2006.

**Depreciation and amortization expense.** For the three months ended December 31, 2006, depreciation and amortization expense amounted to \$65,541 as compared to \$19,371 for the three months ended December 31, 2005, an increase of \$46,170 or 238%. Depreciation expense is provided by use of the straight-line method over the estimated useful lives of the assets. The increase in depreciation was attributable to the amortization of capitalized software development costs. Amortization expense is related to a software library which are intangible assets that we acquired through our previous acquisitions. The decrease in amortization expense of \$5,000, or approximately 50 %, for the three months ended December 31, 2006 as compared to the three months ended December 31, 2005 reflects previous amortizations of this intangible asset.

**General and administrative expense.** For the three months ended December 31, 2006, general and administrative expenses were \$760,366 as compared to \$513,987 for the three months ended December 31, 2005, an increase of \$246,379 or approximately 48%. For the three months ended December 31, 2006 and 2005, general and administrative expenses consisted of the following:

	2006	2005
Salaries and related taxes	\$ 492,635	\$ 250,029
Professional fees	62,692	37,020
Rent	61,108	60,735
Consulting fees	13,058	3,579
Insurance	13,779	52,347
Other operating expenses	117,094	110,277
Total	\$ 760,366	\$ 513,987

·For the three months ended December 31, 2006, salaries and related taxes increased to \$492,635 as compared to \$250,029 for the three months ended December 31, 2005, an increase of \$242,606 or 97%. The increase was attributable to an increase in executive and office salaries for the three months ended December 31, 2006 and the granting of stock options during the three months ended December 31, 2006 to employees which were valued using FASB 123R and resulted in stock-based compensation of \$88,385.



**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)**

- For the three months ended December 31, 2006, professional fees amounted to \$62,692 as compared to \$37,020 for the three months ended December 31, 2005, an increase of \$25,672 or 69%. The increase was primarily attributable to an increase in legal fees incurred of \$16,232 and accounting fees \$9,440.
- For the three months ended December 31, 2006, rent expense amounted to \$61,108 as compared to \$60,735 for the three months ended December 31, 2005, an increase of \$373 or 1%.
- For the three months ended December 31, 2006, consulting expense amounted to \$13,058 as compared to \$3,579 for the three months ended December 31, 2005, an increase of \$9,479. The increase was attributable to an increase in business development initiatives and an increase in investor relations expense during the three months ended December 31, 2006.
- For the three months ended December 31, 2006, insurance expense amounted to \$13,779 as compared to \$52,347 for the three months ended December 31, 2005, a decrease of \$38,568. The decrease was attributable to a decrease in health insurance expense resulting from the reduction of our staff by approximately nine employees.
- For the three months ended December 31, 2006, other operating expenses amounted to \$117,094 as compared to \$110,277 for the three months ended December 31, 2005, an increase of \$6,817 or 6%. The increase was primarily attributable to an increase in operations.

***LOSS FROM OPERATIONS***

We reported a loss from operations of \$599,756 for the three months ended December 31, 2006 as compared to a loss from operations of \$330,740 for the three months ended December 31, 2005, an increase of \$269,016 or approximately 81%.

***OTHER INCOME (EXPENSES)***

Gain from sales of net assets. For the three months ended December 31, 2006, we sold our interest in one of our subsidiaries (Integrated Power Solutions, Inc. or IPS) to a shareholder and related party for the payment of cash to the third party of \$12,000, the assignment to the purchaser of accounts receivable of \$54,609, and assumption by the purchaser of approximately \$205,200 in accounts payable. In connection with this sale, we recorded a gain of \$138,586.

Interest Expense. For the three months ended December 31, 2006, interest expense amounted to \$130,205 as compared to \$20,918 for the three months ended December 31, 2005, an increase of \$109,287 or 522%. The increase in interest expense is attributable to the following: (i) In December 2005, we entered a financing agreement with Sand Hill Finance LLC for the financing of our accounts receivable balances with an annual interest rate of 24% and incurred interest expense for the three months ended December 31, 2006 of approximately \$98,707; (ii) In July 2006, we entered into a sale-leaseback equipment financing arrangement whereby we borrowed \$300,000 and (iii) During three months ended December 31, 2006, we amortized deferred financing costs of \$4,999.

***NET LOSS***

Our net loss was \$590,066 for the three months ended December 31, 2006 compared to \$351,658 for the three months ended December 31, 2005.

**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)*****DEEMED PREFERRED STOCK DIVIDEND***

During the three months ended December 31, 2006 and 2005, we recorded a deemed preferred stock dividend of \$0 and \$500,000, respectively, which relates to our Series A and B Convertible Preferred Stock. This non-cash expense related to the beneficial conversion features of those securities and is recorded with a corresponding credit to paid-in capital.

***NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS***

We reported a net loss attributable to common shareholders of \$590,066 for the three months ended December 31, 2006 as compared to a net loss attributable to common shareholders of \$851,658 during the three months ended December 31, 2005. This translates to an overall per-share loss available to shareholders of \$.06 for the three months ended December 31, 2006 compared to per-share loss of \$.13 for the three months ended December 31, 2005.

***LIQUIDITY AND CAPITAL RESOURCES***

Liquidity is the ability of a company to generate funds to support its current and future operations, satisfy its obligations and otherwise operate on an ongoing basis. The following table provides an overview of certain selected balance sheet comparisons between December 31, 2006 and September 30, 2006:

	December 31, 2006	September 30, 2006	\$ Change	% Change
Working Capital	\$ 1,901,811	\$ 1,626,966	\$ 274,845	16.9%
Cash	288,901	432,885	(143,984)	-33.3%
Accounts receivable, net	1,433,302	1,264,065	169,237	13.39%
Total current assets	1,729,490	1,706,621	22,869	1.34%
Property and equipment, net	365,892	424,559	(58,667)	-13.8%
Goodwill	430,000	211,600	218,400	103.21%
Intangibles, net	35,000	40,000	(5,000)	-12.5%
Deferred financing cost	155,000	159,999	(4,999)	-3.12%
Total assets	2,769,338	2,595,875	173,463	6.68%
Notes payable-related and non-related	1,424,410	1,378,869	45,541	3.3%
Equipment financing payable -current	75,765	79,327	(3,562)	-4.49%
Accounts payable	1,529,424	894,390	635,034	71%
Accrued expenses	581,842	933,722	(351,880)	-37.7%
Advances from related party	19,860	8,123	11,737	144.5%
Total current liabilities	3,631,301	3,333,587	297,714	8.93%
Notes payable - related party	150,000	150,000	-	-
Equipment financing payable-non current	168,149	182,969	(14,820)	-8.09%
Total liabilities	3,949,450	3,666,556	282,894	7.7%
Accumulated deficit	(11,461,108)	(10,871,042)	(590,066)	5.4%
Stockholder's deficit	\$ (1,180,112)	(1,070,681)	(109,431)	10.22%



**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)**

Net cash used in operating activities was \$391,006 for the three months ended December 31, 2006 as compared to net cash used in operating activities of \$434,936 for the three months ended December 31, 2005, a decrease of \$43,930. For the three months ended December 31, 2006, we used cash to fund our net loss of \$590,066 offset by non-cash items such as stock-based compensation of \$158,635, depreciation expense of \$65,541, amortization of deferred financing cost of \$4,999, and a gain on sale of net assets of \$138,586, and as well as changes in assets and liabilities of \$108,471. For the three months ended December 31, 2005, we used cash to fund our net loss of \$351,658 offset by non-cash items such as depreciation expenses of \$9,371, amortization of deferred financing cost of \$5,000 and as well as add back of other non-cash items such as changes in assets and liabilities of \$97,649.

Net cash used in investing activities for the three months ended December 31, 2006 was \$113,874 as compared to net cash used in investing activities of \$239,991 for the three months ended December 31, 2005. During the three months ended December 31, 2006, we had an asset purchase and in connection therewith used cash of \$250,000. Additionally, we used cash of \$1,874 for property and equipment purchases and received net cash from the sale of net assets of one of our subsidiaries of \$138,000 during the three months ended December 31, 2006. During the three months ended December 31, 2005, we purchased equipment and software amounting to \$239,991 which represented the cash used in investing activities. We did not have any company acquisitions or similar transactions during the three months ended December 31, 2005.

Net cash provided by financing activities for the three months ended December 31, 2006 was \$360,896 as compared to \$299,599 for the three months ended December 31, 2005, an increase of \$61,297. For the three months ended December 31, 2006, net cash provided by financing activities related to proceeds received from the exercise of stock options and warrants of \$322,000, proceeds received from notes payable of \$242,041, proceeds received from related party notes and advances of \$41,737 offset by repayments on notes payable of \$200,000, payments on related party advances of \$26,500 and repayments of equipment financing of \$18,382. For the three months ended December 31, 2005, net cash provided by financing activities related to proceeds from bank financing of \$339,476 offset by payment of placement fees of \$46,398, and proceeds received from related party note payable of \$6,521.

At December 31, 2006 we had an accumulated deficit of \$11,461,108 and the report from our independent registered public accounting firm on our audited financial statements at September 30, 2006 contained an explanatory paragraph regarding doubt as to our ability to continue as a going concern as a result of our net losses in operations. We reported a net loss of \$590,066 for the three months ended December 31, 2006 and there are no assurances that we will report net income in any future periods.

Historically, our revenues have not been sufficient to fund our operations and we have relied on capital provided through the sale of equity securities, and various financing arrangements and loans from related parties. At December 31, 2006 we had cash on hand of \$288,901. In fiscal 2006, we entered into a receivable factoring agreement with Sand Hill Finance, LLC under which we can sell certain accounts receivable to the lender on a full recourse basis at 80% of the face amount of the receivable up to an aggregate of \$1.8 million. We agreed to pay Sand Hill Finance, LLC an annual commitment fee of \$10,000 and a monthly finance fee of 2% of the average daily balance under the line. We granted Sand Hill Finance, LLC a blanket security interest in our assets and agreed to refrain from certain actions while the line is outstanding.

**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)**

While we do not have any working capital commitments, we do not presently have any external sources of working capital other than what may be available under the factoring agreement and loans from related parties. Our working capital needs in future periods primarily relies on the rate at which we can increase our revenues while controlling our expenses and decreasing the use of cash to fund operations. Additional capital may be needed to fund acquisitions of additional companies or assets, although we are not a party to any pending agreements at this time and, accordingly, cannot estimate the amount of capital which may be necessary, if any, for acquisitions.

As long as our cash flow from operations remains insufficient to completely fund operations, we will continue depleting our financial resources and seeking additional capital through equity and/or debt financing. In March 2005 we sold shares of our Series A Convertible Preferred Stock and in December 2005 we sold shares of our Series B Convertible Preferred Stock to the same purchaser. The designations of these shares included a restriction that so long as the shares are outstanding, we cannot sell or issue any common stock, rights to subscribe for shares of common stock or securities which are convertible or exercisable into shares of common stock at an effective purchase price of less than the then conversion value which is presently \$0.60 per share for the Series A Convertible Preferred Stock and \$0.2727 for the Series B Convertible Preferred Stock. Under the terms of the Series B Convertible Preferred Stock transaction, we also agreed not to issue any convertible debt or preferred stock. Finally, under the terms of the financing agreement with Sand Hill Finance, LLC we agreed not to incur any additional indebtedness other than trade credit in the ordinary course of business. These covenants may limit our ability to raise capital in future periods.

There can be no assurance that acceptable financing can be obtained on suitable terms, if at all. Our ability to continue our existing operations and to continue growth strategy could suffer if we are unable to raise the additional funds on acceptable terms which will have the effect of adversely affecting our ongoing operations and limiting our ability to increase our revenues and maintain profitable operations in the future. If we are unable to secure the necessary additional working capital as needed, we may be forced to curtail some or all of our operations.

***RECENT FINANCING TRANSACTION***

In February 2006, we reduced the exercise price of common stock purchase warrants to purchase 4,500,000 shares of common stock, all of which are held by Barron Partners LP, to \$1.00 per share through December 31, 2006. On March 17, 2006, we further reduced the exercise price of 500,000 warrants to purchase 500,000 shares of common stock to \$.80 during the period from March 17, 2006 through March 31, 2006. On October 20, 2006, the Company further reduced the exercise price of warrants to purchase 1,000,000 shares of common stock to \$.35 during the period from October 17, 2006 through November 10, 2006. To the extent that those warrants were not exercised by 5:30 PM, Eastern time, on November 10, 2006, the exercise price of those warrants reverted to \$1.00 per share through December 31, 2006 and at that time the warrants reverted back to the original exercise price. During the three months ended December 31, 2006, the warrant holder exercised 500,000 warrants at an exercise price of \$.80 for net proceeds of \$400,000. Additionally, during November 2006, in connection with the exercise of 720,000 stock warrants, we issued 720,000 shares of common stock for cash proceeds of \$252,000.

In May and June 2006, in connection with the exercise of 47,500 stock options, we issued 47,500 shares of common stock for cash proceeds of \$32,000.

**ITEM 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION (continued)**

During June to October 2006, a company that the Company's chief executive officer is a shareholder in lent funds to the Company for working capital purposes. The loan was due no later than 30 days from that date of funding. As consideration for providing the funding, we agreed to issue 1.54 shares of common stock for each dollar lent under the loan. During the three months ended December 31, 2006, we borrowed \$30,000 under this loan agreement and repaid approximately \$26,500. At December 31, 2006, the Company owed this related party \$181,599. Additionally, the related party is due 339,606 common shares under the loan agreement. In October 2006, the related party company waived any further common shares on funds received subsequent to September 30, 2006. At December 31, 2006, in connection with the common shares due under this agreement, the Company has reflected an accrued interest payable of \$169,803 on the accompanying consolidated balance sheet.

On July 6, 2006, we entered into what is in essence a sale and leaseback agreement with respect to certain computer and office equipment. We received gross proceeds of \$300,000 from the sale of the equipment to a third party. As part of the same transaction, we entered into an agreement to lease the equipment back from the third party for 36 monthly rent payment of \$10,398 until August 2009. We accounted for this equipment financing arrangement as a capital lease. In connection with the agreement, we made an initial security deposit of \$30,000 which is included in deposits in the balance sheet at December 31, 2006. The equipment had a net book value of \$37,846 on the date of the transaction. At December 31, 2006, amount due under this equipment financing arrangement amounted to \$243,914.

On September 29, 2006, we borrowed \$200,000 from a shareholder. The note was payable on October 29, 2006 and bears interest at 12% per annum. At September 30, 2006, principal amount due under this note amounted to \$200,000. The Company repaid this loan in October 2006.

During November 2006, in connection with the exercise of 100,000 stock options, we issued 100,000 shares of common stock for cash proceeds of \$35,000.

***RECENT ACCOUNTING PRONOUNCEMENTS***

The Financial Accounting Standards Board has recently issued several new accounting pronouncements:

In February 2006, the FASB issued SFAS 155, which applies to certain "hybrid financial instruments," which are instruments that contain embedded derivatives. The new standard establishes a requirement to evaluate beneficial interests in securitized financial assets to determine if the interests represent freestanding derivatives or are hybrid financial instruments containing embedded derivatives requiring bifurcation. This new standard also permits an election for fair value re-measurement of any hybrid financial instrument containing an embedded derivative that otherwise would require bifurcation under SFAS 133. The fair value election can be applied on an instrument-by-instrument basis to existing instruments at the date of adoption and can be applied to new instruments on a prospective basis. The adoption of SFAS No.155 did not have a material impact on the Company's financial position and results of operations.

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

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". This statement requires all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable, and permits for subsequent measurement using either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of Statement No. 140. The subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value eliminates the necessity for entities that manage the risks inherent in servicing assets and servicing liabilities with derivatives to qualify for hedge accounting treatment and eliminates the characterization of declines in fair value as impairments or direct write-downs. SFAS No. 156 is effective for an entity's first fiscal year beginning after September 15, 2006. The adoption of this statement is not expected to have a significant effect on the Company's future reported financial position or results of operations.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109." This interpretation provides guidance for recognizing and measuring uncertain tax positions, as defined in SFAS No. 109, "Accounting for Income Taxes." FIN No. 48 prescribes a threshold condition that a tax position must meet for any of the benefit of an uncertain tax position to be recognized in the financial statements. Guidance is also provided regarding de-recognition, classification, and disclosure of uncertain tax positions. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect that this interpretation will have a material impact on its financial position, results of operations, or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("FAS 157"). This Statement defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosure related to the use of fair value measures in financial statements. The Statement is to be effective for the Company's financial statements issued in 2008; however, earlier application is encouraged. The Company is currently evaluating the timing of adoption and the impact that adoption might have on its financial position or results of operations

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on the consolidated financial statements upon adoption.

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

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as of September 30, 2006, the end of the period covered by this report, our management concluded its evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, such as this report, is recorded, processed, summarized and reported within the time periods prescribed by SEC rules and regulations, and to reasonably assure that such information is accumulated and communicated to our management, including our Chief Executive Officer who is also our principal financial and accounting officer, to allow timely decisions regarding required disclosure.

Our management does not expect that our disclosure controls and procedures will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

As of the evaluation date, our Chief Executive Officer concluded that we do not maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed in our reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods prescribed by SEC rules and regulations, and that such information is accumulated and communicated to our management, including our Chief Executive Officer, to allow timely decisions regarding required disclosure. In August 2006 our then Chief Financial Officer terminated his employment with us. During the course of our 2006 audit, we determined that we experienced certain material weaknesses of our internal controls during fiscal 2006 related to our failure to timely reconcile the sub-detail reports of our general ledger, including cash, accounts payable and accounts receivable, and in the recordation of equity transactions. We do not presently have a full time Chief Financial Officer or an accounting staff which is sufficiently experienced in the proper application of generally accepted accounting principles. Our Chief Executive Officer who is not an accounting professional is presently serving as our principal financial and accounting officer, our accounting staff is comprised of one person and are currently relying upon the services of an outside consultant to augment our accounting department. Until we expand our staff to include a senior financial officer who has the requisite experience necessary, as well as supplement the staff of our accounting department to include a sufficient number of properly trained employees, it is possible that we will have material weaknesses in our disclosure controls in future periods.

There have been no changes in our internal control over financial reporting during our fourth fiscal quarter 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**

The company is involved with normal day to day legal issues. There is a pending lawsuit with two former employees. The company believes the suit is without merit.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None



Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

Exhibit

<u>Number</u>	<u>Description</u>
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
32.1	Certification of Chief Executive Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *
32.2	Certification of Chief Financial Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *

\* Filed herein

SIGNATURES

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

**ICEWEB, INC.**

February 14, 2007      By: /s/ John R. Signorello  
John R. Signorello  
Principal executive officer and  
Principal accounting Officer