ICEWEB INC
Form 10-Q
February 14, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended December 31, 2012

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission file number: 0-27865

ICEWEB, INC.

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

DELAWARE	**13-2640971**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
22900 Shaw Road, Suite 111 Sterling, VA	**20166**
(Address of principal executive offices)	**(Zip Code)**

(571) 287-2380

(Issuer's telephone number)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

The number of shares of the registrant's Common Stock, $.001 par value, outstanding at February 14, 2013 was: 246,062,080.

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”, “plar “believe”, “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.

OTHER PERTINENT INFORMATION

When used in this quarterly report, the terms “IceWEB”, the “Company”, “we”, “our”, and “us” refers to IceWEB, Inc., a Delaware corporation, and our subsidiaries. The information which appears on our web site at www.iceweb.com is not part of this quarterly report.

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ICEWEB, INC. AND SUBSIDIARIES

FORM 10-Q

QUARTERLY PERIOD ENDED December 31, 2012

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PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

ICEWEB, Inc.

Consolidated Balance Sheets

	December 31, 2012 (Unaudited)	September 30, 2012 (1)
CURRENT ASSETS:		
Cash	$ 81,531	$ 269,594
Marketable securities	206,400	72,000
Accounts receivable, net	604,594	563,320
Inventory	264,068	282,231
Other current assets	28,250	6,875
Prepaid expenses	9,112	19,702
	1,193,955	1,213,721
OTHER ASSETS:		
Property and equipment, net	481,770	499,785
Deposits	13,320	13,320
Other assets	1,545	1,545
Marketable Securities	—	237,600
Deferred financing costs, net	92,060	114,395
Total Assets	$ 1,782,650	$ 2,080,367
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 784,975	$ 824,128
Notes payable	2,075,331	2,059,582
Convertible notes payable, net of discount	6,162	105,175
Notes payable, related party	111,000	—
Derivative liability	484,368	1,104,499
Deferred revenue	2,995	24,897
Total Liabilities	3,464,831	4,118,281
Stockholders' Deficit		
Preferred Stock ($.001 par value; 10,000,000 shares authorized)		
Series B convertible preferred stock ($.001 par value; 626,667 shares issued and outstanding)	626	626
Common stock ($.001 par value; 1,000,000,000 shares authorized; 232,838,029 shares issued and 232,675,529 shares outstanding and 216,443,809 shares issued and 215,943,809 issued and outstanding,	232,677	215,945

respectively)		
Additional paid in capital	39,576,369	38,343,043
Accumulated deficit	(41,604,253)	(40,813,128)
Accumulated other comprehensive income	125,400	228,600
Treasury stock, at cost, (162,500 shares)	(13,000)	(13,000)
Total Stockholders' Deficit	(1,682,180)	(2,037,914)
Total Liabilities and Stockholders' Deficit	$ 1,782,650	$ 2,080,367

See accompanying notes to unaudited consolidated financial statements

(1) Derived from audited financial statements

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ICEWEB, Inc.

Consolidated Statements of Operations

(Unaudited)

	Three Months Ended December 31	
	2012	2011
Sales	$313,411	$758,898
Cost of sales	174,094	472,612
Gross profit	139,317	286,286
Operating expenses:		
Sales and marketing	136,134	112,370
Depreciation and amortization expense	18,016	68,867
Research and development	281,617	208,773
General and administrative	1,002,907	351,244
Total operating expenses	1,438,674	741,254
Loss from operations	(1,299,358)	(454,968)
Other income (expense):		
Gain (loss) on change of fair value of derivative liability	620,131	(287,396)
Interest expense	(111,899)	(286,422)
Total other income (expense):	508,232	(573,818)
Net loss	$(791,126)	$(1,028,786)
Loss per common share basic and diluted	$(0.00)	$(0.01)
Weighted average common shares outstanding basic and diluted	224,478,736	158,074,975

See accompanying notes to unaudited consolidated financial statements

ICEWEB, Inc.

Statement of Consolidated Comprehensive Income

	Three Months Ended December 31	
	2012	2011
Net loss	$(791,126)	$(1,028,786)
Other comprehensive loss, net of tax:		
Unrealized loss on securities	(103,200)	(64,000)
Other comprehensive income (loss)	(103,200)	(64,000)
Comprehensive income (loss)	$(894,326)	$(1,092,786)

See accompanying notes to unaudited consolidated financial statements

ICEWEB, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended December 31,	
	2012	2011
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$(746,583)	$(1,467,205)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	-	(10,507)
NET CASH USED IN INVESTING ACTIVITIES	-	(10,507)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from subscription receivable	-	1,171,520
Proceeds from notes payable	90,748	137,092
Proceeds from exercise of common stock options	394,772	135
Proceeds from the sale of restricted stock	37,000	-
Proceeds from convertible notes payable	-	1,750,000
Proceeds from notes payable – related party	111,000	-
Payment of financing costs	-	(567,547)
Payments on notes payable	(75,000)	(230,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	558,520	2,261,200
NET INCREASE (DECREASE) IN CASH	(188,063)	783,488
CASH - beginning of period	269,594	4,120
CASH - end of period	$81,531	$787,608
Supplemental disclosure of cash flow information:		
Cash paid for :		
Interest	$61,928	$108,907
Income taxes	—	—

See accompanying notes to unaudited consolidated financial statements

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

NOTE 1 - NATURE OF BUSINESS

Headquartered just outside of Washington, D.C., we manufacture high performance unified data storage appliances with enterprise storage management capabilities, and provide Cloud Computing Products/Services. Through thin provisioning, target deduplication and inline compression managed through IceWEB’s proprietary IceSTORM™ Operating System, IceWEB’s unified storage appliances enable standardization, consolidation and optimized storage utilization for virtual and cloud environments, saving up to 90% of storage costs, while reducing space, power and cooling requirements and simplifying storage management. Our customer base includes mid-sized businesses, large enterprises, and government organizations.

Major shifts in data center environments toward virtual and cloud based infrastructures have compounded the need for storage resources that can handle the complex and mixed systems that combine both file and block data. Unified Data Storage from IceWEB reduces this complexity by providing a simplified environment to enable virtualization and cloud computing deployments, protection, and cost savings. Unified Data Storage also provides cost savings through optimized storage utilization, made possible through IceWEB’s thin provisioning, storage pooling, compression and deduplication.

We generate revenue from the manufacture and sale of high-performance unified data storage appliances with IceWEB’s proprietary IceSTORM (STorage Optimization and Resource Management) Operating System and Cloud Computing Services.

NOTE 2 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles and include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Going Concern

We have had losses since inception that raise doubt about our ability to continue as a going concern. In addition and as discussed further in Note 5, we are not in compliance with debt covenants under our Financing Agreements with Sand Hill Finance LLC. For the year ended September 30, 2012 we incurred a net loss of $6,485,048 and for the three months ended December 31, 2012 we incurred a net loss of $791,126, had a use of cash in operating activities of $746,583, and had negative working capital of $2,270,876. 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 we cannot continue in existence.

Management has established plans intended to increase the sales of our 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 we will be able to raise any additional funds.

Investments in Marketable Securities

IceWEB accounts for marketable equity securities in accordance with ASC 320, “Investment – Debt and Equity Securities” with any unrealized gains and losses included as a net amount as a separate component of stockholders’ equity. Certain securities that we may invest in may be determined to be non-marketable. Non-marketable securities where we own less than 20% of the investee are accounted for at cost pursuant to APB No. 18, “The Equity Method of Accounting for Investments in Common Stock”.

Management determines the appropriate classification of its investments at the time of acquisition and reevaluates such determination at each balance sheet date. Trading securities that we may hold are treated in accordance with SFAS No. 115 with any unrealized gains and losses included in earnings. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of tax, reported as a separate component of stockholders’equity (deficit). Investments classified as held-to-maturity are carried at amortized cost. In determining realized gains and losses, the cost of the securities sold is based on the specific identification method.

Under the guidance of ASC 320, “Investments”, we periodically evaluate other-than-temporary impairment (OTTI) of securities to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term “other-than-temporary” is not intended to indicate that the decline is permanent. It indicates that the prospects for a near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding impairment charge to earnings is recognized. In the assessment of OTTI for various securities at September 30, 2012 the guidance in ASC 320, “the Investment-Debt and Equity Securities,” is carefully followed.

Use of Estimates

The preparation of financial statements in accordance with accounting principles 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 balance sheets and the reported amounts of sales and expenses during the reporting periods. Actual results could differ from those estimates. Significant estimates in 2012 and 2011 include the allowance for doubtful accounts, the valuation of stock-based compensation, the allowance for inventory obsolescence, derivative liabilities, and the useful life of property and equipment and intangible assets, and litigation reserves.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

Cash and Cash Equivalents

We consider 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. We recorded a bad debt allowance of $409,000 as of December 31, 2012. Management performs ongoing evaluations of its accounts receivable and has provided a general reserve for bad debt. Management believes that all remaining receivables are fully collectable. Bad debt expense amounted to $0 for the three months ended December 31, 2012 and 2011.

Derivative Liability

Derivatives are required to be recorded on the balance sheet at fair value (see Note 11). These derivatives, including embedded derivatives in the Company's structured borrowings and warrants, are separately valued and accounted for on the Company's balance sheet with changes in fair value charged to operations. Fair values for exchange traded securities and derivatives are based on quoted market prices. Where market prices are not readily available, fair values are determined using market based pricing models incorporating readily observable market data and requiring judgment and estimates. In addition, additional disclosures is required about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows.

Fair Value Measurements

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The established fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

Fair Value of Financial Instruments

The Company’s financial instruments, including cash and cash equivalents, receivables, accounts payable and accrued liabilities and notes payable are carried at cost, which approximates their fair value, due to the relatively short maturity of these instruments.

Our derivative financial instruments, consisting of embedded conversion features in our convertible debt, which are required to be measured at fair value on a recurring basis under FASB ASC 815-15-25 or FASB ASC 815 as of December 31, 2012 are measured at fair value, using a Black-Scholes valuation model which approximates a binomial lattice valuation methodology utilizing Level 3 inputs. Level 3 inputs are unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities (see Note 8).

Inventory

Inventory is valued at the lower of cost or market, on an average cost basis.

Property and Equipment

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

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ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2012

Intangible Assets

Intangible assets, net consists of the cost of acquired customer relationships. We capitalize and amortize the cost of acquired intangible assets over their estimated useful lives on a straight-line basis. The Company periodically reevaluates the carrying value of its intangible assets for events or changes in circumstances that indicate that the carrying value may not be recoverable. As part of this reevaluation, the Company estimates the future cash flows expected to result from the use of the asset. If the sum of the expected future cash flows is less than the carrying amount of the asset, an impairment loss is recognized to reduce the carrying value of the intangible asset to the estimated fair value of the asset.

Long-lived Assets

In accordance with ASC Topic 360, “Property, Plant, and Equipment” (formerly SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”), we review 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.

Advertising

Advertising costs are expensed as incurred and amounted to $18,308 in fiscal Q1 2012 and $13,241 in fiscal Q1 2011.

Revenue Recognition

We follow the guidance of Accounting Standards Codification (ASC) Topic 605, "Revenue Recognition" (formerly Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition") for revenue recognition. In general, we record 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 our various revenues streams:

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.

Earnings per Share

We compute earnings per share in accordance with ASC Topic 260, "Earnings Per Share" (formerly SFAS No. 128, "Earnings per Share"). Under the provisions of ASC Topic 260, 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 antidilutive. At December 31, 2012 and 2011, there were options and warrants to purchase 137,434,996 shares and 110,210,221 shares of common stock, as adjusted, and 626,667 shares issuable upon conversion of Series B preferred stock outstanding, respectively, which could potentially dilute future earnings per share.

Stock-Based Compensation

As more fully described in Note 14, we have a stock option plan that provides for non-qualified and incentive stock options to be issued to directors, officers, employees and consultants (the 2012 Equity Compensation Plan (the "Plan").

We account for stock-based compensation to employees under ASC Topic 718, "Compensation – Stock Compensation, "Share-Based Payments using the modified-prospective-transition method. Under that method, compensation cost is recognized.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012

NOTE 2 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In the first quarter of fiscal year 2013, the Company adopted Accounting Standards Update No. 2011-05, *Comprehensive Income (Topic 220)-Presentation of Comprehensive Income* and Accounting Standards Update No. 2011-12, *Comprehensive Income (Topic 220)-Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.* The adoption of these amended standards impacted the presentation of other comprehensive income, as the Company elected to present two separate but consecutive statements, but did not impact our financial position or results of operations.

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

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012

NOTE 3 - PROPERTY AND EQUIPMENT

Property and equipment, net, consists of the following:

	Estimated Life	December 31, 2012	September 30, 2012
Office equipment	5 years	$ 644,020	$ 644,020
Computer software	3 years	29,523	29,523
Leasehold improvements	5 years	1,033,495	1,033,495
		1,707,038	1,707,038
Less: accumulated depreciation		(1,225,268)	(1,207,253)
		$ 481,770	$ 499,785

Depreciation expense for the three months ended December 31, 2012 and 2011 was $18,016 and $ 68,867 respectively.

NOTE 4 - INVENTORY

Inventory consisted of the following:

	December 31, 2012	September, 30, 2012
Raw materials	$ 177,634	$ 175,258
Work in progress	43,908	42,335
Finished goods	42,526	64,638
	$ 264,068	$ 282,231

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. In conjunction with the acquisition of Inline Corporation in December, 2008, the lending limit on the credit facility was increased to $2,750,000. In addition, the Company and Sand Hill Finance, LLC entered into a 36 month term note agreement in the amount of $1,000,000. Amounts borrowed under the Financing Agreement are secured by a first security interest in substantially all of the Company's assets. At December 31, 2012, the principal amount due under the Financing Agreement amounted to $2,075,331.

Interest on the accounts receivable-based borrowings is payable at a rate of 1.00% per month on the average loan balance outstanding during the year, equal to an annual interest of approximately 12% per year. The Company also agreed to pay an upfront commitment fee of 1% of the credit line upon signing 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 amounts are payable on the anniversary of the agreement.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012

NOTE 5 - NOTES PAYABLE (continued)

In connection with the Financing Agreement, the Company issued Sand Hill Finance, LLC, a seven-year common stock purchase warrant to purchase 25,000 shares of our common stock at an exercise price of $1.00 per share. The exercise price was subsequently reduced to $0.50 per share pursuant to Warrant Amendment Agreement which was executed in conjunction with the convertible debenture. The warrant contains a cashless exercise provision which means that at the option of the holder, the warrant is convertible into a number of shares of our common stock as determined by dividing the aggregate fair market value of the Company's common stock minus the aggregate exercise price of the warrant by the fair market value of one share of common stock. The number of shares issuable upon the exercise of the warrant and the exercise price are subject to adjustment in the event of stock dividends, stock splits and reclassifications. The fair value of the warrant of $16,250 has been recorded as an addition to paid-in capital and interest expense during the year ended September 30, 2008.

In connection with the term note, the Company issued Sand Hill Finance, LLC a seven-year common stock purchase warrant to purchase 120,000 shares of our common stock at an exercise price of $1.00 per share. The exercise price was subsequently reduced to $0.50 per share pursuant to Warrant Amendment Agreement which was executed in conjunction with the convertible debenture. The warrant contains a cashless exercise provision which means that at the option of the holder, the warrant is convertible into a number of shares of our common stock as determined by dividing the aggregate fair market value of the Company's common stock minus the aggregate exercise price of the warrant by the fair market value of one share of common stock. The number of shares issuable upon the exercise of the warrant and the exercise price are subject to adjustment in the event of stock dividends, stock splits and reclassifications. The fair value of the warrant of $13,589 has been recorded as an addition to paid-in capital and deferred finance costs during the year ended September 30, 2009.

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 more, (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.

In November, 2011, in connection with the Company's private placement of convertible notes and Securities Purchase Agreement (see Note 10), Sand Hill Finance, LLC executed an amendment to the Financing Agreement in which Sand Hill Finance LLC agreed that they would not pursue an remedies of default under the Financing Agreement until at least the ninety-first day after the obligations under the convertible notes have been fully satisfied.

NOTE 6 - CONCENTRATION OF CREDIT RISK

Bank Balances

The Company maintains cash in financial institutions insured by the Federal Deposit Insurance Corporation ("FDIC"), including non-interest bearing transaction account deposits protected in full in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). At December 31, 2012 all of the Company's cash balances were fully insured. The Company had not experienced any losses in such accounts. At December 31, 2012 three customers accounted for approximately 89% of our outstanding accounts receivable balance.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012

NOTE 7 - INVESTMENTS

(a) Summary of Investments

Marketable Equity Securities:

As of December 31, 2012, the Company's investments in marketable equity securities are based on the December 31, 2012 stock price as reflected on the OTCBB stock exchange , reduced by a discount factor if those shares have selling restrictions. These marketable equity securities are summarized as follows:

December 31, 2012	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Publicly traded equity securities	$81,000	$ 125,400	$ —	$206,400
Total	$81,000	$ 125,400	$ —	$206,400

September 30, 2012	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Publicly traded equity securities	$81,000	$ 228,600	$ —	$309,600
Total	$81,000	$ 228,600	$ —	$309,600

The unrealized gains are presented in comprehensive income in the consolidated statement of operations and comprehensive income.

(b) Unrealized Gains and Losses on Investments

The following table summarizes the unrealized net gains (losses) associated with the Company's investments:

	Three Months Ended December 31	
	2012	2011
Net gains/(loss) on investments in publicly traded equity securities	$(103,200)	$(64,000)
Net gains on investments	$(103,200)	$(64,000)

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ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012

NOTE 8 – FAIR VALUE MEASUREMENTS

Investment Measured at Fair Value on a Recurring Basis:

	Fair Value Measurements Using:		
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012			
Marketable Equity Securities, net of discount for effect of restriction	$ —	$ —	$ 206,400
Liabilities:			
Derivative liabilities	$ —	$ —	$ 484,368
September 30, 2012			
Marketable Equity Securities, net of discount for effect of restriction	$ —	$ —	$ 309,600
Liabilities:			
Derivative liabilities	$ —	$ —	$ 1,104,499

We categorize the securities as investments in marketable securities available for sale. These securities are quoted either on an exchange or inter-dealer quotation (pink sheet) system. The securities are restricted and cannot be readily resold by us absent a registration of those securities under the Securities Act of 1933 (the "Securities Act") or the availabilities of an exemption from the registration requirements under the Securities Act. As these securities are often restricted, we are unable to liquidate them until the restriction is removed. Unrealized gains or losses on marketable securities available for sale are recognized as an element of comprehensive income based on changes in the fair value of the security. Once liquidated, realized gains or losses on the sale of marketable securities available for sale are reflected in our net income for the period in which the security was liquidated.

There were no impairment charges on investments in publicly traded equity securities for the three months ended December 31, 2012 or 2011.

The Company has evaluated its publicly traded equity securities as of December 31, 2012, and has determined that there were no unrealized losses that indicate an other-than-temporary impairment. This determination was based on several factors, which include the length of time and extent to which fair value has been less than the cost basis and the financial condition and near-term prospects of the issuer, and the Company's intent and ability to hold the publicly traded equity securities for a period of time sufficient to allow for any anticipated recovery in market value.

NOTE 9 - COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income or loss. Other comprehensive income or loss refers to revenue, expenses, gains and losses that under accounting principles generally accepted in the United States are included in comprehensive income but excluded from net income as these amounts are recorded directly as an adjustment to stockholders' equity.

Our accumulated other comprehensive income consists of unrealized gains on marketable securities available for sale of $125,400 at December 31, 2012, and $228,600 at September 30, 2012.

NOTE 10 – CONVERTIBLE NOTES

On November 23, 2011, IceWEB, Inc. (the "Company") entered into a Securities Purchase Agreement (the "Purchase Agreement") with three accredited investors pursuant to which the Company sold $2,012,500 in principal amount of Senior Convertible Notes (the "Notes") and issued the investors Series O, Series P and Series Q Warrants (collectively, the "Warrants") to purchase up to an aggregate of 81,587,843 shares, as adjusted, of the Company's common stock for an aggregate purchase price of $1,750,000 in a private transaction exempt from registration under the Securities Act of 1933, as amended (the "Securities Act") in reliance on an exemption from registration pursuant to Section 4(2) and Regulation D of the Securities Act.   The Company issued the Notes at an original issue discount of 13%.

ICEWEB, INC. AND SUBSIDIARIES

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DECEMBER 31, 2012

	December 31, 2012	September 30, 2012
Principal balance of convertible notes	$ 46,750	$ 164,469
Original issue discount, net	(5,294)	(5,399)
Beneficial conversion feature discount	(35,294)	(53,895)
Convertible notes, net of discount	$ 6,162	$ 105,175

The convertible notes have a principal balance of $46,750, and are carried on the balance sheet at $6,162 net of the remaining unamortized discount, which is being amortized as interest expense over the remaining life of the notes. The convertible notes are convertible into our common stock at a conversion price of $0.074 per share. We can elect to settle any conversion in stock, cash or a combination of stock and cash.

At December 31, 2012, conversion of the outstanding principal amount of the convertible notes would result in the issuance of 631,757 shares of common stock.

NOTE 11 - DERIVATIVE LIABILITIES

Derivative warrant liability

The Company has warrants issued in connection with our convertible notes payable outstanding with price protection provisions that allow for the reduction in the exercise price of the warrants in the event the Company subsequently issues stock or securities convertible into stock at a price lower than the exercise price of the warrants. Simultaneously with any reduction to the exercise price, the number of shares of common stock that may be purchased upon exercise of each of these warrants shall be increased or decreased proportionately, so that after such adjustment the aggregate exercise price payable for the adjusted number of warrants shall be the same as the aggregate exercise price in effect immediately prior to such adjustment. The Company accounted for its warrants with price protection in accordance with FASB ASC Topic 815.

Accounting for Derivative Warrant Liability

The Company's derivative warrant instruments have been measured at fair value at December 31, 2012 using the Black-Scholes model. The Company recognizes all of its warrants with price protection in its consolidated balance sheet as liabilities. The liability is revalued at each reporting period and changes in fair value are recognized currently in the consolidated statements of operations. The initial recognition and subsequent changes in fair value of the derivative warrant liability have no effect on the Company's cash flows.

The derivative warrants outstanding at December 31, 2012 are all currently exercisable with a weighted-average remaining life of 3.90 years.

The revaluation of the warrants at each reporting period, as well as the charges associated with issuing additional warrants due to the price protection features, resulted in the recognition of income of $620,131 and expense of $287,396 within the Company's consolidated statements of operations for the three months ended December 31, 2012 and 2011, respectively, under the caption "Change in fair value of derivative warrant liability". The fair value of the warrants at December 31, 2012 is $484,368 which is reported on the consolidated balance sheet under the caption "Derivative Liability". The following summarizes the changes in the value of the derivative warrant liability from the date of the Company's issuance of derivative warrant instruments on November 23, 2011 until December 31, 2012:

	Value	No. of Warrants
Warrants Issued on November 23, 2011– Derivative warrant liability	$1,750,000	105,012,247
Decrease in fair value of derivative warrant liability	(645,501)	(2,669,628)
Balance at September 30, 2012 – Derivative warrant liability	$1,104,499	102,342,619
Decrease in fair value of derivative warrant liability	(620,131)	--
Balance at December 31, 2012 – Derivative warrant liability	$484,368	102,342,619

Fair Value Assumptions Used in Accounting for Derivative Warrant Liability

The Company has determined its derivative warrant liability to be a Level 3 fair value measurement and has used the Black-Scholes pricing model to calculate the fair value as of December 31, 2012. The Black-Scholes model requires six basic data inputs: the exercise or strike price, time to expiration, the risk free interest rate, the current stock price, the estimated volatility of the stock price in the future, and the dividend rate. Because the warrants contain the price protection feature, the probability that the exercise price of the warrants would decrease as the stock price decreased was incorporated into the valuation calculations. The key inputs used in the December 31, 2012 fair value calculations were as follows:

	December 31, 2012

Current exercise price	$ 0.074	
Time to expiration	3.90 years	
Risk-free interest rate	0.72	%
Estimated volatility	280.5	%
Dividend	-0-	
Stock price on December 31, 2012	$ 0.064	
Expected forfeiture rate	90	%

NOTE 12 - COMMITMENTS

We are on a month to month tenancy in our office space in Sterling, Virginia, as our two-year operating lease expired on March 31, 2011. The office lease agreement had certain escalation clauses and renewal options. We currently have no future minimum rental payments under operating leases.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012

Note 13 – Stockholders' Deficit

Common Stock Warrants

The outstanding warrants at December 31, 2012 have a weighted average exercise price of $0.085 per share and have a weighted average remaining life of 3.69 years.

Certain of these warrants contain certain provisions which cause them to be classified as derivative liabilities pursuant to Accounting Standards Codification subtopic 815-40, *"Derivatives and hedging—Contracts in Entity's Own Equity"* (ASC 815-40). Accordingly, upon issuance the warrants were recorded as a derivative liability and valued at a fair market value of $1,750,000. The fair value of these warrants was decreased to $484,368 as of December 31, 2012. The non-cash income adjustment recorded in the Statement of Operations for the three months ended December 31, 2012 was $620,131. We are required to continue to adjust the warrants to fair value through current period operations for each reporting period.

The Company issued warrants for 83,682,624 common shares, as adjusted, with a current exercise price of $0.074, as adjusted, which have price protection provisions that allow for the reduction in the current exercise price upon the occurrence of certain events, including the Company's issuance of common stock or securities convertible into or exercisable for common stock, such as options and warrants, at a price per share less than the exercise price then in effect. For instance, if the Company issues shares of its common stock or options exercisable for or securities convertible into common stock at an effective price per share of common stock less than the exercise price then in effect, the exercise price will be reduced to the effective price of the new issuance. Simultaneously with any reduction to the exercise price, the number of shares of common stock that may be purchased upon exercise of each of these warrants shall be increased proportionately, so that after such adjustment the aggregate exercise price payable for the adjusted number of warrants shall be the same as the aggregate exercise price in effect immediately prior to such adjustment.

The Company's issuance of the following securities will not trigger the price protection provisions of the warrants described above that were issued in connection with the November 2011 private placement: (a) shares of common stock or standard options to the Company's directors, officers, employees or consultants pursuant to a board-approved equity compensation program or other contract or arrangement; (b) shares of common stock issued upon the conversion or exercise of any security, right or other instrument convertible or exchangeable into common stock (or securities exchangeable into common stock) issued prior to November 23, 2011; and (c) shares of common stock and warrants in connection with strategic alliances, acquisitions, mergers, and strategic partnerships, the primary purpose of which is not to raise capital, and which are approved in good faith by the Company's board of directors.

In October, 2012 we issued 10,433,853 warrants with a one year life and a conversion price of $0.08 per share. These warrants are unregistered, do not have price protection, and were issued to a consultant for services rendered to the Company.

A summary of the status of the Company's outstanding common stock warrants as of December 31, 2012 and changes during the period ending on that date is as follows:

	Number of Warrants	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance outstanding at September 30, 2012	118,434,173	$		