

ICEWEB INC  
Form 10-Q  
February 14, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Form 10-Q

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**

(State or other jurisdiction of

incorporation or organization)

**13-2640971**

(I.R.S. Employer

Identification No.)

**22900 Shaw Road, Suite 111 Sterling, VA**

(Address of principal executive offices)

**20166**

(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  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

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

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”, “plan”, “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](http://www.iceweb.com) is not part of this quarterly report.

**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)
<b>CURRENT ASSETS:</b>		
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
<b>OTHER ASSETS:</b>		
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
<b>CURRENT LIABILITIES:</b>		
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
<b>Stockholders' Deficit</b>		
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

**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)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	-	(10,507 )
NET CASH USED IN INVESTING ACTIVITIES	-	(10,507 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
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
<b>Supplemental disclosure of cash flow information:</b>		
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.



**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)

## 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****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****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

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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	\$ 0.0844	3.84	-
Granted	10,433,853	\$ 0.080	0.75	-
Exercised	0	\$ -	-	-
Forfeited	(25,000 )	\$ 1.000	-	-
Balance outstanding at December 31, 2012	128,843,026	\$ 0.085	3.69	-

#### NOTE 14 - STOCK OPTION PLAN

In August 2012, the Board of Directors adopted the 2012 Equity 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 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.



**ICEWEB, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****DECEMBER 31, 2012**

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.

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.

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,	
	2012	2011
Expected volatility	36% - 278%	N/A
Expected term	1 – 36 months	N/A
Risk-free interest rate	0.72%	N/A
Forfeiture Rate	0% - 45%	N/A
Expected dividend yield	0.00%	N/A

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, 2012, total stock-based compensation charged to operations for option-based arrangements amounted to \$77,411. At December 31, 2012, there was approximately \$279,210 of total unrecognized compensation expense related to non-vested option-based compensation arrangements under the Plan.

**ICEWEB, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****DECEMBER 31, 2012**

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

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance outstanding at September 30, 2012	8,353,185	\$ 0.077	3.78	\$ 45,409
Granted	13,288,785	0.074	-	-
Exercised	(13,050,000)	0.074	-	-
Forfeited	-	-	-	-
Balance outstanding at December 31, 2012	8,591,970	\$ 0.077	3.85	\$ 31,437

**NOTE 15 - SEGMENT REPORTING**

Although the Company has a number of operating divisions, separate segment data has not been presented as they meet the criteria for aggregation as permitted by ASC Topic 280, "Segment Reporting" (formerly Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures About Segments of an Enterprise and Related Information").

Our chief operating decision-maker is considered to be our 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. Therefore, the Company has determined that it operates in a single operating segment, specifically, web communications services. For the periods ended December 31, 2012 and 2011 all material assets and revenues of the Company were in the United States.

**NOTE 16 – SUBSEQUENT EVENTS**

The Company has evaluated subsequent events through the filing date of this Form 10-Q, and determined that no subsequent events have occurred that would require recognition in the financial statements or disclosure in the notes thereto other than as discussed in the accompanying notes.

## **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, 2012 and 2011 should be read in conjunction with the consolidated financial statements, including footnotes, appearing elsewhere in this quarterly report.

### **OVERVIEW**

Headquartered just outside of Washington, D.C., we manufacture high performance unified data storage appliances with enterprise storage management capabilities. 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.

### **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, 2012 and notes thereto contained on Form 10-K 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.

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 consolidated 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.

We account for stock based compensation under ASC Topic 718, "Compensation – Stock Compensation. ASC Topic 718 establishes the financial accounting and reporting standards for stock-based compensation plans. As required by ASC Topic 718, 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 ASC Topic 718 will have a negative impact on our future results of operations.

Revenue Recognition - We follow the guidance of Accounting Standards Codification (ASC) Topic 605, "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.

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.

### **THREE MONTHS ENDED DECEMBER 31, 2012 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2011**

The following table provides an overview of certain key factors of our results of operations for the three months ended December 31, 2012 as compared to the three months ended December 31, 2011:

	Three months ended December 31,		\$ of
	2012	2011	Change
Net Revenues	\$313,411	\$758,898	\$(445,487 )
Cost of sales	174,094	472,612	(295,518 )
Operating Expenses:			
Marketing and selling	136,134	112,370	23,764
Depreciation and amortization	18,016	68,867	(50,851 )
Research and development	281,617	208,773	72,844
General and administrative	1,002,907	351,244	651,663
Total operating expenses	1,438,674	741,254	697,421
Loss from operations	(1,299,358)	(454,968 )	(844,390 )
Total other income (expense)	508,232	(573,818 )	1,082,050
Net loss	\$(791,126 )	\$(1,028,786)	\$237,660

## Other Key Indicators:

	Three months ended		
	December 31, 2012	December 31, 2011	% Change
Cost of sales as a percentage of revenues	55.5 %	62.3 %	(6.8 )%
Gross profit margin	44.5 %	37.7 %	6.8 %
General and administrative expenses as a percentage of revenues	321.0%	46.3 %	274.7 %
Total operating expenses as a percentage of revenues	460.0%	97.7 %	362.3 %

**Revenues**

For the three months ended December 31, 2012, we reported revenues of \$313,411 as compared to revenues of \$758,898 for the three months ended December 31, 2011, a decrease of \$445,487 or approximately 58.7%.

**Cost of Sales**

Our cost of sales consists primarily of products purchased and component parts for the manufacture of our storage products. For the three months ended December 31, 2012 cost of sales was \$174,094, or approximately 55.5% of revenues, compared to \$472,612, or approximately 62.3% of revenues, for the three months ended December 31, 2011. The decrease in costs of sales as a percentage of revenue and the corresponding increase in our gross profit margin for the three months ended December 31, 2012 as compared to the three months ended December 31, 2011 was the result of higher costs for certain components of cost of goods in the prior year, primarily hard drives, resulting from the disruption of supply due to the flooding in Thailand in October, 2011. Our cost of goods has returned to what we believe are normalized levels. We anticipate that our gross profit margins will remain between 45% and 50% through the balance of fiscal 2013, as our short-term sales strategy is to aggressively compete to win business and increase brand awareness. We may see some improvement in margins once the world-wide supply of hard drives normalizes.

**Total Operating Expenses**

Our total operating expenses increased approximately 94.5% to \$1,438,674 for the three months ended December 31, 2012 as compared to \$741,254 for the three months ended December 31, 2011. These changes include:





- Marketing and selling. For the three months ended December 31, 2012, marketing and selling costs were \$136,134 as compared to \$112,370 for the three months ended December 31, 2011, an increase of \$23,764 or approximately 21.1%. The increase was due to an increase in sales and marketing related headcount during the three months ended December 31, 2012 versus the prior year.
- Depreciation and amortization expense. For the three months ended December 31, 2012, depreciation and amortization expense amounted to \$18,016 as compared to \$68,867 for the three months ended December 31, 2011. The decrease was primarily due to certain assets being fully depreciated in the prior year.
- Research and Development. For the three months ended December 31, 2012, research and development costs were \$281,617 as compared to \$208,773 for the three months ended December 31, 2011, an increase of 72,844 or approximately 34.9%.
- General and administrative expense. For the three months ended December 31, 2012, general and administrative expenses were \$1,002,907 as compared to \$351,244 for the three months ended December 31, 2011, an increase of \$654,690 or approximately 186.4%. For the three months ended December 31, 2012 and 2011 general and administrative expenses consisted of the following:

	Fiscal Q1 2013	Fiscal Q1 2012
Occupancy	\$8,313	\$10,764
Consulting	91,133	1,610
Employee compensation	250,091	206,479
Professional fees	65,330	45,345
Internet/Phone	2,248	2,002
Travel/Entertainment	14,552	13,025
Investor Relations	519,096	28,487
Insurance	5,656	2,594
Other	46,488	40,938
	\$1,002,907	\$351,244

• For the three months ended December 31, 2012, Occupancy expense decreased to \$8,313 as compared to \$10,764. Occupancy expense is lower due to changes in headcount.

• For the three months ended December 31, 2012, Consulting expense increased to \$91,133 as compared to \$1,610, an increase of \$89,523. The increase was due to consulting expense incurred related to business development efforts in the current fiscal year.

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For the three months ended December 31, 2012, salaries and related expenses increased to \$250,091 as compared to \$206,479. Employee compensation is higher primarily due to higher expense related to stock based compensation of \$125,579.

For the three months ended December 31, 2012, Professional fee expense increased to \$65,330 as compared to \$45,345. Professional fee expense increased primarily due to legal fees incurred in the normal course of business.

For the three months ended December 31, 2012, travel and entertainment expense increased to \$14,552 as compared to \$13,025. Travel and entertainment expense increased as a result of increased travel for investor relations and general corporate purposes.

For the three months ended December 31, 2012, Other expense amounted to \$46,488 as compared to \$40,938 for the three months ended December 31, 2011, an increase of \$5,550, or 13.6%.

For the three months ended December 31, 2012 Investor relations expense increased to \$519,096 as compared to \$28,487 for the three months ended December 31, 2011. The increase is due to an increase in general investor relations activity.

We anticipate that general and administrative expenses will continue to remain flat during the balance of fiscal 2013, with the exception of share-based payments that the Company may incur from time to time.

***LOSS FROM OPERATIONS***

We reported a loss from operations of \$1,299,358 for the three months ended December 31, 2012 as compared to a loss from operations of \$454,968 for the three months ended December 31, 2011, an increase of \$844,390 or approximately 185.6%.

***OTHER INCOME (EXPENSES)***

Interest Expense. For the three months ended December 31, 2012, interest expense amounted to \$111,899 as compared to \$286,422 for the three months ended December 31, 2011, a decrease of \$174,523 or 60.9%. The decrease in interest expense is primarily attributable to the lower amortization of deferred financing costs, and the decrease in borrowings and certain interest bearing liabilities.

Gain on change of fair value of derivative liability. For the three months ended December 31, 2012 we incurred a decrease in the value of the derivative liability of \$620,131 as compared to an increase in the value of the derivative liability of \$287,396 for the three months ended December 31, 2011.

***NET LOSS***

Our net loss was \$791,126 for the three months ended December 31, 2012 compared to a loss of \$1,028,786 for the three months ended December 31, 2011.

***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, 2012 and September 30, 2012:

December 31,	September 30,	\$	%
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	2012	2012	Change	Change
Working Capital	\$(2,270,876 )	\$(2,904,560 )	\$633,684	(21.8 %)
Cash	81,531	269,594	(188,063)	(69.8 %)
Accounts receivable, net	604,594	563,320	41,274	7.3 %
Marketable Securities, current	206,400	72,000	182,400	153.3 %
Inventory	264,068	282,231	(18,163 )	(6.4 %)
Total current assets	1,193,955	1,213,721	(178,166)	(14.7 %)
Property and equipment, net	481,770	499,786	(18,016 )	(3.6 %)
Marketable Securities	-	237,600	(237,600)	(100.0 %)
Deferred financing costs, net	92,060	114,396	(22,336 )	(19.5 %)
Total assets	1,782,650	2,080,369	(297,719)	(14.3 %)
Accounts payable and accrued liabilities	784,975	824,128	(39,153 )	(4.8 %)
Notes payable	2,075,331	2,059,582	15,749	0.8 %
Convertible notes payable, net of discount	6,162	105,175	(99,013 )	(94.1 %)
Derivative liability	484,368	1,104,499	(620,131)	(56.1 %)
Total current liabilities	3,464,831	4,118,281	(653,450)	(15.9 %)
Accumulated deficit	(41,604,253)	(40,813,128)	(791,125)	1.9 %
Stockholders' deficit	(1,682,180 )	(2,037,912 )	355,732	(17.5 %)

Net cash used by operating activities was \$746,583 for the three months ended December 31, 2012 as compared to net cash used in operating activities of \$1,467,205 for the three months ended December 31, 2011, a decrease of \$720,622. For the three months ended December 31, 2012, we had a net loss of \$791,126, along with non-cash expense of \$145,411, and a decrease in derivative liability of \$620,131, offset by changes in assets and liabilities of \$100,723. During the three months ended December 31, 2012 we experienced an increase in accounts receivable of \$41,274, and a decrease in accounts payable and accrued liabilities during the period of \$38,050. For the three months ended December 31, 2011, we used cash to fund our net loss of \$1,028,786 offset by non-cash items such as depreciation and amortization expense of \$68,867, share-based compensation expense of \$11,047, offset by changes in assets and liabilities of \$959,621. Also during the three months ended December 31, 2011 we experienced an increase in accounts receivable of \$60,826, and a decrease in accounts payable and accrued liabilities during the period of \$677,013.

Net cash used in investing activities for the three months ended December 31, 2012 was \$0 as compared to net cash used in investing activities of \$10,507 for the three months ended December 31, 2011. During the three months ended December 31, 2011, we used cash of \$10,507 for property and equipment purchases.

Net cash provided by financing activities for the three months ended December 31, 2012 was \$558,520 as compared to net cash provided of \$2,261,200 for the three months ended December 31, 2011. For the three months ended December 31, 2012, net cash provided by financing activities related to proceeds from notes payable of \$90,748 which were advances under our factoring line with Sand Hill Finance LLC, proceeds from the exercise of common stock options of \$394,772, proceeds from the sale of restricted stock of \$37,000, and proceeds from a note payable with related parties of \$111,000 offset by repayments on notes payable of \$75,000 which were to pay down the balance on the Sand Hill Finance LLC factoring line. For the three months ended December 31, 2011, net cash provided by financing activities related to proceeds received from subscriptions receivable of \$1,171,520, proceeds from notes payable of \$137,092 which were advances under our factoring line with Sand Hill Finance LLC, proceeds from the issuance of convertible notes of \$1,750,000, and proceeds from the exercise of common stock options of \$135, offset by repayments on notes payable of \$230,000 which were to pay down the balance on the Sand Hill Finance LLC factoring line, and payment of deferred financing costs of \$567,547.

At December 31, 2012 we had a working capital deficit of \$2,270,876 and an accumulated deficit of \$41,604,253.

The report from our independent registered public accounting firm on our audited financial statements for the fiscal year ended September 30, 2012 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. Our sales were not sufficient to pay our operating expenses. We reported a net loss of \$791,126 for the three months ended December 31, 2012. There are no assurances that we will report income from operations 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, 2012 we had cash on hand of \$81,531. 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 \$3.0 million. At December 31, 2012 we owed Sand Hill Finance, LLC \$2,075,331 under this line.

We do not have any commitments for capital expenditures. Our working capital needs in future periods are dependent primarily 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. Also, 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. This covenant 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.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

None.

#### **Item 4. Controls and Procedures**

*Evaluation of disclosure controls and procedures.* Our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) have evaluated the effectiveness of our disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by the Quarterly Report (the “evaluation date”). They have concluded that, as of the evaluation date, these disclosure controls and procedures were effective to ensure that material information relating to us and our consolidated subsidiaries would be made known to them by others within those entities and would be disclosed on a timely basis.

*Changes in internal control over financial reporting.* There were no changes to internal controls over financial reporting that occurred during the three months ended December 31, 2012, that have materially affected, or are reasonably likely to materially impact, our internal controls over financial reporting.

## **PART II - OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

None

#### **Item 1A. Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed under the heading “Risk Factors” in our Annual Report on Form 10-K filed on December 28, 2012, which could materially affect our business operations, financial condition or future results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business operations and/or financial condition. There have been no material changes to our risk factors since the filing of our Form 10-K.

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

During December 2012, in connection with the payment for consulting services rendered, we issued 112,000 shares of common stock. The services were valued at \$8,288 on the date of issuance. The issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 4(2) of that act.



On November 13, 2012 we issued 918,919 shares of restricted common stock at a per share price of \$0.074 valued at \$68,000, in lieu of pay to our employees. The issuance was exempt from registration under the Securities Act of 1933 in reliance on an exemption provided by Section 4(2) of that act.

**Item 3. Defaults Upon Senior Securities**

None

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

None

**Item 5. Other Information**

None

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**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
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 pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *
32.2	Certification of Chief Financial Officer 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, 2013 By: /s/ Rob Howe III  
Rob Howe III  
Chief Executive  
Officer, principal  
executive officer

February 14, 2013 By: /s/ Mark B. Lucky  
Mark B. Lucky  
Chief Financial  
Officer, principal  
financial and  
accounting officer