

ICEWEB INC  
Form 10QSB  
February 14, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

(Mark One)

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

For the period ended December 31, 2007

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

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

Commission file number: 0-27865

**ICEWEB, INC.**

(Exact name of 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.)

**205 Van Buren Street, Suite 150**

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**Herndon, VA 20170**

(Address of principal executive offices)

**(703) 964-8000**

(Issuer's telephone number)

**Not Applicable**

(Former name, former address, and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: At February 13, 2008, there were 15,800,338 outstanding shares of common stock, \$.001 par value per share.

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

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**CAUTIONARY STATEMENT REGARDING FORWARD LOOKING INFORMATION**

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

**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 its 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-QSB**

**QUARTERLY PERIOD ENDED December 31, 2007**

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**PART I - FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****ICEWEB, Inc.****Consolidated Balance Sheet****December 31, 2007****(Unaudited)****CURRENT ASSETS:**

|  |            |
|--|------------|
| Cash   | \$ 658,697 |
| Accounts receivable, net of allowance of \$9,000 | 2,935,795  |
| Inventory, net of allowance of \$106,541         | 503,024    |
| Prepaid expenses                                 | 111,254    |
|  | 4,208,770  |

**OTHER ASSETS:**

|   |              |
|---|--------------|
| Property and equipment, net                                     | 743,596      |
| Deposits  | 74,456       |
| Intangible assets, net of accumulated amortization of \$192,131 | 183,348      |
| Goodwill  | 1,575,945    |
| Total Assets  | \$ 6,786,115 |

**CURRENT LIABILITIES:**

|  |              |
|--|--------------|
| Accounts payable and accrued liabilities | \$ 4,962,452 |
| Notes payable                            | 2,732,821    |
| Notes payable-related party              | 100,296      |
| Deferred revenue                         | 22,069       |
|  | 7,817,638    |

**Long-Term Liabilities**

|                   |           |
|-------------------|-----------|
| Notes payable     | 65,221    |
| Total Liabilities | 7,882,859 |

**Stockholders Deficit**

|  |               |
|--|---------------|
| Preferred stock (\$.001 par value; 10,000,000 shares authorized)   |               |
| Series A convertible preferred stock (\$.001 par value; 0 shares issued and outstanding)                                     |               |
| Series B convertible preferred stock (\$.001 par value; 1,833,334 shares issued and outstanding)                             | 1,833         |
| Common stock (\$.001 par value; 1,000,000,000 shares authorized; 15,000,338 shares issued and 14,837,838 shares outstanding) | 15,002        |
| Additional paid in capital   | 13,231,294    |
| Accumulated deficit  | (14,331,873 ) |
| Treasury stock, at cost, (162,500 shares)  | (13,000 )     |
| Total stockholders deficit   | (1,096,744 )  |

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Total liabilities and stockholders deficit

\$6,786,115

See accompanying notes to unaudited consolidated financial statements

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**ICEWEB, Inc.****Consolidated Statements of Operations**

|  | <b>Three Months Ended</b> |               |
|--|---------------------------|---------------|
|  | <b>December 31</b>        |               |
|  | <b>2007</b>               | <b>2006</b>   |
| <b>Sales</b>   | \$ 4,212,732              | \$ 2,581,777  |
| <b>Cost of sales</b>   | 3,613,816                 | 2,295,410     |
| <b>Gross profit</b>  | 598,916                   | 286,367       |
| <b>Operating expenses:</b>                                   |                           |               |
| Marketing and selling  | 29,405                    | 60,216        |
| Depreciation and amortization                                | 75,831                    | 65,541        |
| General and administrative                                   | 1,006,948                 | 760,366       |
| <b>Total Operating Expenses</b>                              | 1,112,184                 | 886,123       |
| <b>Loss From Operations</b>                                  | (513,268 )                | (599,756 )    |
| <b>Other income (expenses):</b>                              |                           |               |
| Gain/(loss) from sale of assets                              |                           | 138,586       |
| Interest income  | 924                       | 1,309         |
| Interest expense   | (97,636 )                 | (130,205 )    |
| <b>Total other income (expenses):</b>                        | (96,712 )                 | 9,690         |
| <b>Net loss</b>  | \$ (609,980 )             | \$ (590,066 ) |
| Basic and diluted loss per common share                      | \$ (0.05 )                | \$ (0.06 )    |
| Weighted average common shares outstanding basic and diluted | 13,305,466                | 9,423,344     |

See accompanying notes to unaudited consolidated financial statements

**ICEWEB, Inc.****Consolidated Statements of Cash Flows****(Unaudited)**

|   | <b>Three Months Ended</b> |              |
|---|---------------------------|--------------|
|   | <b>December 31,</b>       |              |
|   | <b>2007</b>               | <b>2006</b>  |
| NET CASH PROVIDED/(USED) IN OPERATING ACTIVITIES                    | \$ 724,231                | \$ (391,006) |
| CASH FLOWS FROM INVESTING ACTIVITIES:                               |                           |              |
| Purchase of property and equipment                                  | (9,892)                   | (1,874)      |
| Net cash received from sale of net assets                           |                           | 138,000      |
| Cash used in acquisitions, net                                      | (1,538,407)               | (250,000)    |
| NET CASH USED IN INVESTING ACTIVITIES                               | (1,548,299)               | (113,874)    |
| CASH FLOWS FROM FINANCING ACTIVITIES:                               |                           |              |
| Repayment of equipment financing                                    | (21,480)                  | (18,382)     |
| Proceeds from notes payable - related party                         | 1,482                     | 30,000       |
| Repayment of notes payable - related party                          | (8,540)                   | (26,500)     |
| Net proceeds from related party advances                            |                           | 11,737       |
| Proceeds from notes payable   | 2,812,247                 | 242,041      |
| Payments on notes payable   | (2,393,414)               | (200,000)    |
| Proceeds from exercise of common stock options                      |                           | 35,000       |
| Proceeds from exercise of common stock warrants                     |                           | 287,000      |
| NET CASH PROVIDED BY FINANCING ACTIVITIES                           | 390,295                   | 360,896      |
| NET DECREASE IN CASH  | (433,773)                 | (143,984)    |
| CASH - beginning of period  | 1,092,470                 | 432,885      |
| CASH - end of period  | \$ 658,697                | \$ 288,901   |
| Supplemental disclosure of cash flow information:                   |                           |              |
| Cash paid for :   |                           |              |
| Interest  | \$ 97,636                 | \$ 125,518   |
| Income taxes  |                           |              |
| Non-cash transactions affecting investing and financing activities: |                           |              |
| Conversion of shares of preferred stock to shares of common stock   | 456,667                   |              |
| Acquisition details:  |                           |              |
| Goodwill  | \$ 1,575,945              | \$ 430,000   |
| Liabilities assumed   | \$ 1,616,814              | \$ 180,000   |
| Common stock issued   | \$ 876,845                |              |
| Fair value of assets acquired                                       | \$ 3,095,022              | \$           |
| Cash paid   | \$ 2,177,308              | \$ 250,000   |

See accompanying notes to unaudited consolidated financial statements





**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

**NOTE 1 - NATURE OF BUSINESS**

**The Company**

The Company's history and acquisition strategy has been a key to our development as a company. We began as a full service provider of computer systems and professional services to private sector corporations and to the federal government under a General Services Administration (GSA) schedule contract for computer systems and peripherals. Between 2001 and 2004, the Company undertook a series of strategic acquisitions which resulted in its business and operations during fiscal 2006. During fiscal 2006 it also acquired PatriotNet, an Internet service provider. As a result of these acquisitions, during fiscal 2006 the Company's business and operations were primarily centered on providing hosted web-based collaboration solutions that enabled organizations to establish Internet, Intranet, and email/collaboration services immediately and with little or no up-front capital investment.

Following the end of fiscal 2006, the Company sold three of its subsidiaries, The Seven Corporation, PatriotNet and Integrated Power Solutions. On November 15, 2006, the Company acquired certain of the assets of True North Solutions related to its governmental customer business, including the customers, forecast, contract renewals, and GSA schedule.

On December 22, 2007 the Company acquired Inline Corporation ( Inline ), a leading edge provider of data storage solutions to the corporate and government markets.

See Note 4 for further description of the Company's acquisition and dispositions.

As a result of this acquisition and these divestitures the Company's core business is primarily now sales of storage area network solutions, software services, application development, network integrated technology, and third party hardware sales.

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

Our interim consolidated financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the interim consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the statement of the results for the interim periods

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presented. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto, as well as the accompanying Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended September 30, 2007 included in our Annual Report on Form 10-KSB. Interim financial results are not necessarily indicative of the results that may be expected for a full year.

### **Reclassifications**

Certain reclassifications have been made to previously reported amounts to conform to 2007 amounts.

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**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

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

**Going Concern**

The Company's auditors stated in their report on the consolidated financial statements of the Company for the years ended September 30, 2007 and 2006 that the Company is dependent on outside financing and has had losses since inception that raise doubt about its ability to continue as a going concern. For the three months ended December 31, 2007, the Company incurred a net loss of \$609,980 which included noncash expenses of \$180,559. Cash provided from operations totaled \$724,231. The consolidated financial statements do not include any adjustments related to the recovery and classification of recorded assets, or the amounts and classification of liabilities that might be necessary in the event the Company cannot continue in existence.

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

**Use of estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in 2008 and 2007 include the allowance for doubtful accounts, the valuation of stock-based compensation, the useful life of intangible assets and property and equipment, and the valuation of goodwill.

**Cash and Cash Equivalents**

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

**Accounts Receivable**

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Accounts receivable consists of normal trade receivables. The Company recorded a bad debt allowance of \$9,000 as of December 31, 2007. Management performs ongoing evaluations of its accounts receivable. Management believes that all remaining receivables are fully collectable. Bad debt expense amounted to \$0 and \$0 for the three months ended December 31, 2007 and 2006, respectively.

### **Intangible Assets**

Intangible assets, net consists of the cost of acquired customer relationships and the value of Federal contracts that the Company acquired in the acquisition of certain assets of True North. The Company capitalizes and amortizes the cost of acquired intangible assets over their estimated useful lives on a straight-line basis. The estimated useful lives of the Company's acquired customer relationships and Federal government contracts is three years.

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**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

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

**Property and Equipment**

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

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

**Goodwill**

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

The Company does not amortize goodwill but tests goodwill impairment at least on an annual basis, or earlier when events or changes in circumstances suggest the carrying amount may not be fully recoverable. Such evaluation is performed by comparing the implied fair value of a reporting unit to its carrying value, including goodwill. An impairment loss is recognized in the current period if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value. The Company performed its latest annual impairment test with regard to the carrying value of goodwill as of December 31, 2007. For the three months ended December 31, 2007, the Company did not record any impairment to goodwill.

**Long-lived Assets**

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

exceeds its fair market value.

**Revenue Recognition**

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

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**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

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

**Revenue Recognition (continued)**

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

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

**Earnings per Share**

The Company computes earnings per share in accordance with Statement of Accounting Standards No. 128, Earnings per Share ( SFAS No. 128 ). Under the provisions of SFAS No. 128, basic earnings per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing the net income (loss) for the period by the weighted average number of common and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of the common shares issuable upon the exercise of stock options and warrants (using the treasury stock method) and upon the conversion of convertible preferred stock (using the if-converted method). Potentially dilutive common shares are excluded from the calculation if their effect is anti-dilutive. At December 31, 2007, there were options and warrants to purchase 11,632,219 shares of common stock and 1,833,334 shares issuable upon conversion of Series B preferred stock which could potentially dilute future earnings per share.

**Stock-Based Compensation**

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



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Effective January 1, 2006 we adopted the fair value recognition provisions of FASB Statement No. 123 (revised 2004), *Share-Based Payment*, ( SFAS 123(R) ) which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and directors, including employee stock options, based on estimated fair values. We had previously applied Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, ( APB 25 ) and related Interpretations and provided the required pro forma disclosures of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ( SFAS 123 ) which was superseded by SFAS 123(R). The Company has also applied the provisions of Staff Accounting Bulletin No. 107 ( SAB 107 ) in the adoption of SFAS 123(R).

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**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

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

**Stock-based compensation (continued)**

We elected to adopt the modified prospective application transition method as provided by SFAS 123(R). In accordance with the modified prospective transition method, consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Under that transition method, compensation cost recognized in the three months ended December 31, 2007 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2007, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R).

**NOTE 3 - PROPERTY AND EQUIPMENT**

At December 31, 2007, property and equipment consisted of the following:

|                                | <b>Estimated Life</b> |             |
|--------------------------------|-----------------------|-------------|
| Office equipment               | 5 years               | \$ 579,277  |
| Computer software              | 3 years               | 710,721     |
| Vehicles                       | 3 years               | 17,330      |
| Furniture and fixtures         | 5 years               | 155,410     |
| Leasehold improvements         | 3 years               | 499,050     |
|                                |                       | 1,961,788   |
| Less: accumulated depreciation |                       | (1,218,192) |
|                                |                       | \$ 743,596  |

Depreciation expense for the three months ended December 31, 2007 and 2006 was \$74,115 and \$65,541 respectively.

**NOTE 4 - ACQUISITION AND DISPOSITIONS**

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

**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

**NOTE 4 - ACQUISITIONS AND DISPOSITIONS (continued)**

In November 2006, the Company sold its interest in one of its subsidiaries (Integrated Power Solutions, Inc. or IPS) to a then key employee and shareholder of the Company for the payment of cash to the third party of \$12,000, and assumption by the purchaser of approximately \$180,000 in accounts payable. In connection with this sale, the Company recorded a gain of \$138,586.

On November 15, 2006, we acquired certain assets of True North Solutions ( True North ) related to its governmental customer business for \$430,000 of which \$250,000 was paid in cash at closing and the balance was paid through the delivery of a \$100,000 principal amount promissory note secured by collateral pledge of the assets, payable immediately upon accomplishment of the novation of the GSA Schedule. Additionally the Company accrued \$80,000 in finder s fees payable to a principal shareholder in connection with this acquisition. Under the terms of the agreement, we acquired the customers, forecast, contract renewals, and GSA schedule of True North Solutions. We have permitted True North Solutions to use the purchased assets until the novation of the GSA Schedule is complete pursuant to which we are acting as the seller s subcontractor. We have provided the documentation necessary to secure the novation of the GSA schedule, and are awaiting notice from the Federal government. The novation is expected to occur by March 31, 2008.

On February 16, 2007 we sold 100% of the outstanding stock of our subsidiary, The Seven Corporation of Virginia, Inc., to PC NET in exchange for the waiver of approximately \$11,000 we owed PC NET. Under the terms of the agreement we may not engage in any staffing services businesses as The Seven Corporation had conducted for a period of at least two years.

On December 22, 2007, we acquired 100% of the outstanding stock of Inline for \$1,311,318 in cash, plus 503,356 shares of IceWEB common stock valued at \$276,846, the fair market value on the date of acquisition. The acquisition was accounted for using the purchase method of accounting. The results of operations are included in the financial statements of operations from the date of acquisition. Inline is a leading provider of intelligent enterprise data storage solutions and services. Inline s proprietary products include reliable, high performance Storage Area Network Solutions, Network Attached Storage, and Direct Attached Storage and the rapidly expanding OEM Storage Centric Appliances. Today, Inline has developed its fifth generation of advanced data storage solutions, marketed under the brands *TruEnterprise* and *FileStorm*. All Inline systems function in a heterogeneous operating system environment, including Windows, Unix and Linux. The purchase of Inline Corporation included the acquisition of assets of \$2,352, 114, and liabilities of \$1,616,814. We are still evaluating the allocation of the purchase price of the acquisition.

The following table summarizes the required disclosures of the pro forma combined entity, as if the acquisition of Inline and certain assets of True North occurred at October 1, 2006.

|               | <b>For the Three Months Ended December</b> |              |
|---------------|--|--------------|
|               | <b>31,</b>                                 |              |
|               | <b>2007</b>                                | <b>2006</b>  |
| Revenues, net | \$ 5,854,960                               | \$ 3,955,593 |

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|   |           |           |
|---|-----------|-----------|
| Net loss                                    | (462,569) | (376,065) |
| Net loss per common share basic and diluted | (0.03)    | (0.04)    |

The above unaudited pro forma results have been prepared for comparative purposes only and do not purport to be indicative of results of operations that actually would have resulted had the acquisition occurred at October 1, 2006, nor is it necessarily indicative of future operating results.

**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

**NOTE 5 - RELATED PARTY TRANSACTIONS**

Note Payable - Related Party

During the year ended 2007, a company that the Company's chief executive officer is a shareholder in lent funds to the Company for working capital purposes. As consideration for providing the funding, the Company agreed to issue 1.54 shares of common stock for each dollar lent under the loan. During the three months ended December 31, 2007, the Company borrowed approximately \$1,482 under this loan agreement and repaid approximately \$16,956. At December 31, 2007, the Company owed this related party \$100,296. Additionally, at September 30, 2006 the related party was due 339,606 common shares under the loan agreement. The Company valued these common shares at the fair market value on the dates of grant of \$.50 per share or \$169,803 based on the trading price of common shares. In March, 2007 the Company issued 339,606 common shares as payment of the accrued interest payable.

**NOTE 6 - 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 December, 2007 the agreement was amended to increase the maximum balance up to \$3,000,000. Amounts borrowed under the Financing Agreement are secured by a first security interest in substantially all of the Company's assets. At December 31, 2007, the principal amount due under the Financing Agreement amounted to \$2,632,366.

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

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

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

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

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**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

**NOTE 6 - NOTES PAYABLE (continued)**

At June 30, 2007, the Company retired a promissory note to a stockholder in the amount of \$150,000, plus accrued interest of \$96,875, in exchange for 200,000 shares of the Company's common stock. The note bore interest at the rate of 12.5% per annum and was due on demand.

Note Payable - Other

In May 2005, the Company issued to this stockholder 125,000 shares of common stock as consideration for the extension of the maturity date of the note by 10 years to September 30, 2014 which had been orally agreed to in fiscal 2004. The shares were valued at \$200,000, the fair value at the date of issuance. The cost associated with these shares has been accounted for as deferred finance charges to be amortized over the life of the deferral period. The unamortized deferred finance cost of \$145,000 was taken as a charge to interest expense in June, 2007. For the three months ended December 31, 2007 and 2006, amortization of deferred financing costs amounted to \$0 and \$4,999 respectively, and is included in interest expense on the accompanying consolidated statements of operations.

**NOTE 7 - EQUIPMENT FINANCING PAYABLE**

On July 6, 2006, the Company entered into what is in essence a sale and leaseback agreement with respect to certain computer and office equipment. The Company received gross proceeds of \$300,000 from the sale of the equipment to a third party. As part of the same transaction, the Company entered into an agreement to lease the equipment back from the third party for 36 monthly rent payments of \$10,398 until August 2009. The Company accounted for this equipment financing arrangement as a capital lease. In connection with the agreement, the Company made an initial security deposit of \$30,000 and is included in deposits in the balance sheet at December 31, 2007. The equipment had a net book value of \$37,846 on the date of the transaction. In connection with the financing, the Company did not record any gain or loss. Imputed interest on this financing is 20% per annum. At December 31, 2007, the principal amount due under this equipment financing arrangement amounted to \$163,565. From time to time we have failed to make the monthly payments due under this agreement on a timely basis. Should the lessor declare us in default, it would be entitled to accelerate all amounts due under the agreement which are approximately \$165,000 at December 31, 2007. If we were unable to satisfy such amount, the lessor could retake the equipment thereby depriving us of its use which could materially affect our business and operations.

**NOTE 8 - CONCENTRATION OF CREDIT RISK**

Bank Balances



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The Company maintains its cash bank deposits at various financial institutions which, at times, may exceed federally insured limits. Accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000. At December 31, 2007, the Company had approximately \$416,650 in excess of FDIC insured limits. The Company has not experienced any losses in such accounts.

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## ICEWEB, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2007

## NOTE 9 - STOCKHOLDERS DEFICIT

## Common Stock Warrants

A summary of the status of the Company's outstanding common stock warrants as of December 31, 2007 and changes during the period ending on that date is as follows:

|  | Number of<br>Warrants | Weighted<br>Average<br>Exercise<br>Price |
|--|-----------------------|--|
| <u>Common Stock Warrants</u>   |                       |  |
| Balance at beginning of year   | 5,955,000             | \$ 1.25                                  |
| Granted  |                       |  |
| Exercised  |                       |  |
| Forfeited  |                       |  |
| Balance at end of period   | 5,955,000             | \$ 1.25                                  |
| Warrants exercisable at end of period  | 5,955,000             | \$ 1.25                                  |
| Weighted average fair value of warrants granted or re-priced during the period |                       | \$                                       |

The following table summarizes information about common stock warrants outstanding at December 31, 2007:

| Warrants Outstanding          |   |   | Warrants Exercisable                     |   |  |
|-------------------------------|---|---|--|---|--|
| Range of<br>Exercise<br>Price | Number<br>Outstanding at<br>December 31, 2007 | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Weighted<br>Average<br>Exercise<br>Price | Number<br>Exercisable at<br>December 31, 2007 | Weighted<br>Average<br>Exercise<br>Price |
| \$ 0.45                       | 75,000  | 1.78 Years  | \$ 0.45                                  | 75,000  | \$ 0.45                                  |
| 0.65                          | 175,000                                       | 3.16 Years  | 0.65                                     | 175,000                                       | 0.65                                     |
| 0.70                          | 175,000                                       | 2.25 Years  | 0.70                                     | 175,000                                       | 0.70                                     |
| 1.00                          | 5,200,000                                     | 2.58 Years  | 1.00                                     | 5,200,000                                     | 1.00                                     |

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|      |           |            |         |           |         |
|------|-----------|------------|---------|-----------|---------|
| 2.00 | 5,000     | 3.56 Years | 2.00    | 5,000     | 2.00    |
| 4.00 | 162,500   | 1.54 Years | 1.00    | 162,500   | 4.00    |
| 8.00 | 162,500   | 2.00 Years | 8.00    | 162,500   | 8.00    |
|      | 5,955,000 |            | \$ 1.25 | 5,955,000 | \$ 1.25 |

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**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

**NOTE 10 - STOCK OPTION PLAN**

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

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

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

As amended in April, 2007, the Plan permits the grant of options and shares for up to 10,000,000 shares of the Company's common stock. The Plan terminates 10 years from the date of the Plan's adoption by the Company's stockholders.

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

**ICEWEB, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

**NOTE 10 - STOCK OPTION PLAN (continued)**

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

|                         | <b>December 31,</b> |             |
|-------------------------|---------------------|-------------|
|                         | <b>2007</b>         | <b>2006</b> |
| Expected volatility     | 56% - 103%          | 100% - 110% |
| Expected term           | 3 Years             | 5 years     |
| Risk-free interest rate | 4.39% - 4.57%       | 4%          |
| Expected dividend yield | 0%                  | 0%          |

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

For the three months ended December 31, 2007, total stock-based compensation charged to operations for option-based arrangements amounted to \$106,444. At December 31, 2007, there was approximately \$981,812 of total unrecognized compensation expense related to non-vested option-based compensation arrangements under the Plan.

A summary of the status of the Company's outstanding stock options as of December 31, 2007 and changes during the period ending on that date is as follows:

|                              | <b>Number of<br/>Options</b> |    | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> |
|------------------------------|------------------------------|----|--|
| <u>Stock options</u>         |                              |    |  |
| Balance at beginning of year | 5,212,219                    | \$ | 0.61   |
| Granted                      | 1,095,000                    |    | 0.55   |
| Exercised                    |                              |    |  |
| Forfeited                    | (630,000)                    |    | 0.55   |
| Balance at end of period     | 5,677,219                    | \$ | 0.60   |

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|  |           |    |      |
|--|-----------|----|------|
| Options exercisable at end of period                           | 2,659,186 | \$ | 0.62 |
| Weighted average fair value of options granted during the year |           | \$ | 0.55 |

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## ICEWEB, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2007

## NOTE 10 - STOCK OPTION PLAN (continued)

The following table summarizes information about employee stock options outstanding at December 31, 2007:

| Range of Exercise Price | Options Outstanding                     |   |                                 | Weighted Average Exercise Price | Options Exercisable                     |                                 |
|-------------------------|---|---|---------------------------------|---------------------------------|---|---------------------------------|
|                         | Number Outstanding at December 31, 2007 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |                                 | Number Exercisable at December 31, 2007 | Weighted Average Exercise Price |
| \$ 0.25 - 0.55          | 2,190,000                               | 3.32 Years                                  | \$ 0.47                         | 1,254,867                       | \$ 0.41                                 |                                 |
| 0.56 - 0.80             | 3,392,500                               | 4.12 Years                                  | 0.62                            | 1,309,600                       | 0.65                                    |                                 |
| 1.20 - 1.60             | 19,344                                  | 0.68 Years                                  | 1.44                            | 19,344                          | 1.44                                    |                                 |
| 3.20 - 3.80             | 75,375                                  | 0.74 Years                                  | 3.20                            | 75,375                          | 3.20                                    |                                 |
|                         | 5,677,219                               |   | \$ 0.60                         | 2,659,186                       | \$ 0.62                                 |                                 |

## NOTE 11 - SEGMENT REPORTING

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

IceWEB's chief operating decision-maker is considered to be the chief executive officer (CEO). The CEO reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance. The financial information reviewed by the CEO is identical to the information presented in the accompanying consolidated statements of operations. Therefore, IceWEB has determined that it operates in a single operating segment, specifically, reselling hardware and software. For the three months ended December 31, 2007 and 2006 all material assets and revenues of IceWEB were in the United States.

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

The following analysis of our consolidated financial condition and results of operations for the three months ended December 31, 2007 and 2006, should be read in conjunction with the consolidated financial statements, including footnotes, appearing elsewhere in this quarterly report.

### OVERVIEW

IceWEB, Inc. through our Solutions Group, is a provider of computer network security products and solutions, such as access control, content filtering, email security, intrusion detection, and the latest layer 7 firewall technology, primarily to Federal, state and local governments. The significant increase in our sales for the three months ended December 31, 2007 over the comparable period in fiscal 2007 is primarily due to the growth in Solutions Group revenue. We continue to execute on our strategy to significantly increase our presence in the Federal IT marketplace and we believe that our acquisition of True North Federal Solutions Group in 2006 has laid a strong foundation for our future success.

In addition to our governmental customer business, we provide hosted web-based collaboration solutions through our online product offerings in our IceWEB Online group. Our subscription-based Hosted Microsoft Exchange services, enterprise software and network security infrastructure products and services are targeted towards small- and medium-sized business. The Internet-based a-la-carte suite of robust, hosted software application services are used in both public and private sectors. Currently IceWEB Online products include IceMAIL (messaging), IceVISTA (web hosting), and IcePORTAL (Intranet service). Its goal is to bring enterprise-class technology, normally affordable by only large corporations, to small business customers via a low-priced, recurring monthly subscription model. This model, coupled with minimal or no startup costs, makes implementing IceWEB more cost-effective and efficient for small businesses.

In December, 2007 we acquired Inline, a manufacturer of storage area network applications and solutions. This acquisition repositions the Company to manufacture and sell its own branded storage area network products and solutions to Federal, state, local governments, and commercial customers. For the three months ended December 31, 2007, revenue from Inline included in the operating results for IceWEB, Inc. amounted to \$191,301. Going forward it is anticipated that Inline storage products will make a significant contribution to IceWEB's results of operations. Inline's facility is located in Sterling, Virginia, approximately five miles from IceWEB's headquarters location.

### 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.



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A summary of significant accounting policies is included in Note 1 to the audited consolidated financial statements included for the year ended September 30, 2007 and notes thereto contained on Form 10-KSB of the Company as filed with the Securities and Exchange Commission. Management believes that the application of these policies on a consistent basis enables us to provide useful and reliable financial information about the company's operating results and financial condition.

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.

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

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

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

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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, 2007 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2006

The following table provides an overview of certain key factors of our results of operations for the three months ended December 31, 2007 as compared to the three months ended December 31, 2006:

|                               | <b>Three months ended</b> |              | <b>\$ of</b> | <b>%</b> |
|-------------------------------|---------------------------|--------------|--------------|----------|
|                               | <b>December 31,</b>       | <b>2006</b>  |              |          |
|                               | <b>2007</b>               |              |              |          |
| Net Revenues                  | 4,212,732                 | 2,581,777    | 1,630,955    | 63%      |
| Cost of sales                 | 3,613,816                 | 2,295,410    | 1,318,406    | 57%      |
| Operating Expenses:           |                           |              |              |          |
| Marketing and selling         | 29,405                    | 60,216       | (30,811)     | (51%)    |
| Depreciation and amortization | 75,831                    | 65,541       | 10,290       | 16%      |
| General and administrative    | 1,006,948                 | 760,366      | 246,582      | 32%      |
| Total operating expenses      | 1,112,184                 | 886,123      | 226,061      | 26%      |
| Loss from operation           | (513,268)                 | (599,756)    | 86,488       | (14%)    |
| Total other income (expense)  | (96,712)                  | 9,690        | (106,402)    | (1098%)  |
| Net loss                      | \$ (609,980)              | \$ (590,066) | \$ (19,914)  | 3%       |

Other Key Indicators:

|   | <b>Three months ended</b> |             | <b>%</b> |
|---|---------------------------|-------------|----------|
|   | <b>December 31,</b>       | <b>2006</b> |          |
|   | <b>2007</b>               |             |          |
| Cost of sales as a percentage of revenues                       | 85.8%                     | 88.9%       | (3.1%)   |
| Gross profit margin   | 14.2%                     | 11.1%       | 3.1%     |
| General and administrative expenses as a percentage of revenues | 23.9%                     | 29.5%       | (5.6%)   |
| Total operating expenses as a percentage of revenues            | 26.4%                     | 34.3%       | (7.9%)   |

#### **Revenues**

For the three months ended December 31, 2007, we reported revenues of \$4,212,732 as compared to revenues of \$2,581,777 for the three months ended December 31, 2006, an increase of \$1,630,955 or approximately 63%. The increase is primarily due to an increase in our third party product sales through our IceWEB Solutions Group which accounted for approximately 95% of our revenue. Revenues from Inline from

the date of acquisition totaled \$191,301.

*Cost of Sales*

Our cost of sales consists of products purchased for resale, and third party contractors. For the three months ended December 31, 2007, cost of sales was \$3,613,816, or approximately 85.8% of revenues, compared to \$2,295,410, or approximately 88.9% of revenues, for the three months ended December 31, 2006. 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, 2007 as compared to the three months ended December 31, 2006 was the result of improved mix of higher margin products during the three months ended December 31, 2007 in infrastructure and hardware revenues as a percentage of total revenue. We anticipate that our gross profit margins will continue to improve through the balance of fiscal 2008, as IceWEB product revenue will make up a larger percentage of total revenue, primarily through sales of Inline storage products.

*Total Operating Expenses*

Our total operating expenses increased approximately 26% to \$1,112,184 for the three months ended December 31, 2007 as compared to \$886,123 for the three months ended December 31, 2006. These changes include:

Marketing and Selling. For the three months ended December 31, 2007, marketing and selling costs were \$29,405 as compared to \$60,216 for the three months ended December 31, 2006, a decrease of \$30,811 or approximately 51%. The decrease was due to a decrease in IceWEB Online web marketing, advertising and print advertising during the three months ended December 31, 2007.

Depreciation and amortization expense. For the three months ended December 31, 2007, depreciation and amortization expense amounted to \$75,831 as compared to \$65,541 for the three months ended December 31, 2006, an increase of \$10,290 or 16%. The increase in amortization was primarily attributable to the amortization of the GSA schedule costs which were acquired as part of the True North transaction in November, 2006.

General and administrative expense. For the three months ended December 31, 2007, general and administrative expenses were \$1,006,948 as compared to \$760,366 for the three months ended December 31, 2006, an increase of \$246,582 or approximately 32%. For the three months ended December 31, 2007 and 2006 general and administrative expenses consisted of the following:

|                       | <b>Fiscal Q1<br/>2008</b> | <b>Fiscal Q1<br/>2007</b> |
|-----------------------|---------------------------|---------------------------|
| Occupancy             | 52,032                    | 64,776                    |
| Consulting            | 38,505                    | 32,847                    |
| Employee compensation | 655,597                   | 482,282                   |
| Professional fees     | 24,496                    | 32,595                    |
| Internet/Phone        | 22,313                    | 15,152                    |
| Travel/Entertainment  | 30,770                    | 29,559                    |
| Investor Relations    | 45,199                    | 10,308                    |
| Licenses              | 1,173                     | 1,372                     |
| Insurance             | 15,316                    | (1,126)                   |
| Other                 | 104,897                   | 87,542                    |
| Leased Equipment      | 16,650                    | 5,059                     |
|                       | 1,006,948                 | 760,366                   |



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For the three months ended December 31, 2007, salaries and related expenses increased to \$655,597 as compared to \$482,282. Employee compensation is higher due to higher sales commission expense of \$29,438, higher expense related to amortization of deferred compensation related to employee stock options of \$18,787, and \$27,007 in salaries associated with the acquisition of Inline. Average headcount was higher by approximately four, resulting in higher compensation expense.

For the three months ended December 31, 2007, Other expense amounted to \$104,897 as compared to \$87,542 for the three months ended December 31, 2006. The increase was due to a one-time charge for credit card fees of \$20,049 and \$10,684 of miscellaneous tax and auto expense related to the acquisition of Inline.

For the three months ended December 31, 2007 Investor relations expense increased to \$45,199 as compared to \$10,308 for the three months ended December 31, 2006. The increase is due to an increased number of road shows and a general increase in investor relations activity.

We anticipate that general and administrative expenses will continue to remain flat during the balance of fiscal 2008, after factoring in the additional operating costs associated with the acquisition of Inline, 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 \$513,268 for the three months ended December 31, 2007 as compared to a loss from operations of \$599,756 for the three months ended December 31, 2006, an improvement of \$86,488 or approximately 14%.

### ***OTHER INCOME (EXPENSES)***

Gain from sales of net assets. Gain on sale of assets for the three months ended December 31, 2006 represents the gains from the sales of our Integrated Power Solutions and The Seven Corporation subsidiaries as described in Note 4 of the Notes to Unaudited Consolidated Financial Statements appearing elsewhere herein. We did not have comparable transactions during the three months ended December 31, 2007.

Interest Income. Interest income for the three months ended December 31, 2007 amounted to \$924 and represented interest earned on interest bearing cash accounts. This compares to \$1,309 in interest income in the comparable period in fiscal 2006.

Interest Expense. For the three months ended December 31, 2007, interest expense amounted to \$97,636 as compared to \$130,205 for the three months ended December 31, 2006, a decrease of \$32,569 or 25%. The decrease in interest expense is primarily attributable to the payoff of certain interest bearing liabilities in the third and fourth quarters of fiscal 2007. Also, during the three months ended December 31, 2006, we amortized deferred financing costs of \$5,000, as compared to \$0 during the three months ended December 31, 2007.

### ***NET LOSS***

Our net loss was \$609,980 for the three months ended December 31, 2007 compared to \$590,066 for the three months ended December 31, 2006.



**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, 2007 and September 30, 2006:

|  | <b>December 31,<br/>2007</b> | <b>September 30,<br/>2007</b> | <b>\$<br/>Change</b> | <b>%<br/>Change</b> |
|--|------------------------------|-------------------------------|----------------------|---------------------|
| Working Capital                          | (3,608,867)                  | (1,981,325)                   | 1,627,542            | 82.1%               |
| Cash                                     | 658,697                      | 1,092,470                     | (433,773)            | (39.7%)             |
| Accounts receivable, net                 | 2,935,795                    | 5,115,428                     | (2,179,633)          | (42.6%)             |
| Total current assets                     | 4,208,770                    | 6,243,714                     | (2,034,944)          | (32.6%)             |
| Property and equipment, net              | 743,596                      | 344,728                       | 398,868              | 115.7%              |
| Goodwill                                 | 1,575,945                    | -                             | 1,575,945            | N/A                 |
| Intangibles, net                         | 183,348                      | 211,305                       | (27,957)             | (13.2%)             |
| Inventory                                | 503,024                      | 8,097                         | 494,927              | 6112.8%             |
| Total assets                             | 6,786,115                    | 6,853,702                     | (67,587)             | (1.0%)              |
| Accounts payable and accrued liabilities | 4,962,452                    | 5,805,256                     | (842,806)            | (14.5%)             |
| Notes payable-current                    | 2,732,821                    | 2,293,560                     | 439,261              | 19.2%               |
| Note payable - related party             | 100,296                      | 115,767                       | (15,471)             | (13.4%)             |
| Deferred revenue                         | 22,069                       | 10,456                        | 11,613               | 111.1%              |
| Total current liabilities                | 7,817,637                    | 8,225,039                     | (407,402)            | (5.0%)              |
| Notes payable-long term                  | 65,221                       | 98,716                        | (33,495)             | (33.9%)             |
| Total liabilities                        | 7,882,858                    | 8,323,755                     | (440,897)            | (5.3%)              |
| Accumulated deficit                      | (14,331,873)                 | (13,721,164)                  | (610,709)            | 4.5%                |
| Stockholders' deficit                    | (1,096,744)                  | (1,470,053)                   | 373,309              | (25.4%)             |

Net cash provided by operating activities was \$724,231 for the three months ended December 31, 2007 as compared to net cash used in operating activities of \$391,006 for the three months ended December 31, 2006, an increase of \$1,115,237. For the three months ended December 31, 2007, we used cash to fund our net loss of \$609,980 offset by non-cash items such as depreciation expense of \$74,115, share-based compensation expense of \$106,444, and offset by changes in assets and liabilities of \$183,175. Also during the three months ended December 31, 2007 we experienced increases in collections of accounts receivable of \$2,179,632, which was offset by a decrease in accounts payable during the period of \$842,805. For the three months ended December 31, 2006, we used cash to fund our net loss of \$590,066 offset by non-cash items such as depreciation expenses of \$65,541, as well as the add back of other non-cash items such as changes in assets and liabilities of \$133,519.

Net cash used in investing activities for the three months ended December 31, 2007 was \$1,548,299 as compared to net cash used in investing activities of \$113,874 for the three months ended December 31, 2006. During the three months ended December 31, 2007, we used net cash of \$1,538,407 as partial consideration in our acquisition of Inline. Additionally, we used cash of \$9,892 for property and equipment purchases. During the three months ended December 31, 2006, we had an asset purchase and in connection therewith used cash of \$250,000. Additionally, we used cash of \$1,874 for property and equipment purchases and received net cash from the sale of net assets of one of our subsidiaries of \$138,000 during the three months ended December 31, 2006.





Net cash provided by financing activities for the three months ended December 31, 2007 was \$390,295 as compared to net cash provided of \$360,896 for the three months ended December 31, 2006. For the three months ended December 31, 2007, net cash provided by financing activities related to proceeds received from notes payable of \$2,812,247 which were advances under our factoring line with Sand Hill Finance LLC, proceeds received from related party notes and advances of \$1,482 offset by repayments on notes payable of \$2,393,415 which were to pay down the balance on the Sand Hill Finance LLC factoring line, payments on related party advances of \$8,540 and repayments of equipment financing of \$21,480. For the three months ended December 31, 2006, net cash provided by financing activities related to proceeds received from the exercise of stock options and warrants of \$322,000, proceeds received from notes payable of \$242,041, proceeds received from related party notes and advances of \$41,737 offset by repayments on notes payable of \$200,000, payments on related party advances of \$26,500 and repayments of equipment financing of \$18,382.

At December 31, 2007 we had a working capital deficit of \$3,608,868 and an accumulated deficit of \$14,331,873. The report from our independent registered public accounting firm on our audited financial statements for the fiscal year ended September 30, 2007 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. While our sales increased significantly during the three months ended December 31, 2007, our gross profit margin was approximately 14% and our sales were not sufficient to pay our operating expenses. We reported a net loss of \$609,980 for the three months ended December 31, 2007. Our core business historically has not generated high margins and 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, 2007 we had cash on hand of \$658,697. 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, 2007 we owed Sand Hill Finance, LLC \$2,632,366 under this accounts receivable line.

While we do not have any commitments for capital expenditures, we owe a related party \$100,296. At December 31, 2007 and at such time as the novation of the GSA contract is received we will owe \$100,000 to the seller of the True North Assets. In addition, in connection with our annual report for our fiscal year ending September 30, 2008 our management will be required to provide an assessment of the effectiveness of our internal control over financial reporting, including a statement as to whether or not internal control over financial reporting is effective. In order to comply with this requirement we will need to engage a consulting firm to undertake an analysis of our internal controls. We have yet to engage such a consulting firm and are unable at this time to predict the costs associated with our compliance with Section 404 of Sarbanes-Oxley Act of 2002. We do not presently have any external sources of working capital other than what may be available under the factoring agreement with Sand Hill Finance and loans from related parties. 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. In March 2005 we sold shares of our Series A Convertible Preferred Stock and in December 2005 we sold shares of our Series B Convertible Preferred Stock to the same purchaser. The designations of these shares included a restriction that so long as the shares are outstanding, we cannot sell or issue any common stock, rights to subscribe for shares of common stock or securities which are convertible or exercisable into shares of common stock at an effective purchase price of less than the then conversion value which is presently \$0.60 per share for the Series A Convertible Preferred Stock and \$0.2727 for the Series B Convertible Preferred Stock. Under the terms of the Series B Convertible Preferred Stock transaction, we also agreed not to issue any convertible debt or preferred stock. Finally, under the terms of the financing agreement with Sand Hill Finance, LLC we agreed not to incur any additional indebtedness other than trade credit in the ordinary course of business. These covenants may limit our ability to raise capital in future periods.

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

### ***RECENT ACCOUNTING PRONOUNCEMENTS***

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

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

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

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



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

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

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

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as of December 31, 2007, the end of the period covered by this report, our management concluded its evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, such as this report, is recorded, processed, summarized and reported within the time periods prescribed by SEC rules and regulations, and to reasonably assure that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

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

As of the evaluation date, our Chief Executive Officer and Chief Financial Officer concluded that we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed in our reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods prescribed by SEC rules and regulations, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There have been no changes in our internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

Item 1. Legal Proceedings

None

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

On October 18, 2007 we issued 1,000,000 shares of our common stock in connection with the acquisition of Inline, valued at \$600,000 as a finder's fee. The recipient was an unrelated third party accredited investor and 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.

During the first quarter of fiscal 2008, Series A preferred stockholders converted 456,667 shares of Series A Preferred Stock into 456,667 shares of common stock. The recipient was an accredited investor and the issuance were 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

Item 6. Exhibits

Exhibit  
Number

Description

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 \*

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32.2      Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 \*

\* Filed herein

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**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, 2008

By: /s/ John R. Signorello  
John R. Signorello,  
Chief Executive Officer, principal executive officer

February 14, 2008

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