INDUSTRIAL SERVICES OF AMERICA INC /FL
Form 10-K
March 27, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

[x] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For Fiscal Year Ended December 31, 2006

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission File No.: 0-20979

INDUSTRIAL SERVICES OF AMERICA, INC.
(Exact name of registrant as specified in its charter)

Florida (State or other jurisdiction of incorporation or organization)	59-0712746 (I.R.S. Employer Identification No.)

7100 Grade Lane
P.O. Box 32428
Louisville, Kentucky 40232
(502) 368-1661
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.005 par value
(Title of class)

Indicate by check mark if the registrant is a well-seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ___ No _X_

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ___ No _X_

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
(Check one): Large accelerated filer ____ Accelerated filer ____ Non-accelerated filer _X_

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

Aggregate market value of the 1,861,574 shares of voting Common Stock held by non-affiliates of the registrant at the closing sales price on June 30, 2006: $10,704,050.

Number of shares of Common Stock, $.005 par value, outstanding as of the close of business on March 22, 2007: 3,640,899.

DOCUMENT INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2007 Annual Meeting of Shareholders are incorporated by reference into Item 10 through Item 14 of Part III of this report.

PART I

Item 1. Business.

General

Industrial Services of America, Inc. (herein "ISA," the "Company," "we," "us," "our," or other similar terms), is a Louisville, Kentucky-based logistic management services company that offers total package waste and recycling management services to commercial, industrial and logistic customers nationwide, as well as providing recycling and scrap processing and waste handling equipment sales and service.

Available Information

We make available, free of charge, through our website www.isa-inc.com, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, and amendments to those reports as soon as reasonably practicable after we have electronically filed with the Securities and Exchange Commission. We also make available on our website our audit committee charter, our Business Ethics Policy and Code of Conduct and our Code of Ethics for the CEO, CFO and senior financial officers. Please note that our Internet address is included in this annual report on Form 10-K as an inactive textual reference only. Information contained on our website is not incorporated by reference into this annual report on Form 10-K and should not be considered a part of this report.

Our principal products and services are ferrous and non-ferrous scrap metals, management services, and waste equipment sales, rental and service. Our goal is to remain dedicated to the recycling, management services, and equipment industry while sustaining steady growth at an acceptable profit, adding to our net worth, and providing positive returns for our stockholders.

Recycling Operations -- ISA Recycling

Since October 2005, we have focused much of our attention on our recycling business segment. We sell processed ferrous and non-ferrous scrap material to end-users such as steel mini-mills, integrated steel makers and foundries and refineries. We purchase ferrous and non-ferrous scrap material primarily from industrial and commercial generators of steel, iron, aluminum, copper, stainless steel and other metals as well as from other scrap dealers who deliver these materials directly to our facilities. We process these materials by sorting, shearing, cutting and/or baling. We also continue to focus on initiating growth in our management services business segment and our waste and recycling equipment sales, service and leasing division.

Ferrous Operations

Ferrous Scrap Purchasing - We purchase ferrous scrap from two primary sources: (i) industrial and commercial generators of steel and iron; and (ii) scrap dealers, peddlers, and other generators and collectors who sell us steel and iron scrap, known as obsolete scrap. Market demand and the composition, quality, size and weight of the materials are the primary factors that determine prices paid to these material providers.

Ferrous Scrap Processing - We prepare ferrous scrap material for resale through a variety of methods including sorting, shearing, cutting and bailing. We produce a number of differently sized, shaped and grade products depending upon customer specifications and market demand.

Sorting - After purchasing ferrous scrap material, we inspect it to determine how we should process it to maximize profitability. In some instances, we may sort scrap material and sell it without further processing. We separate scrap material for further processing according to its size, composition and grade by using conveyor systems, front-end loaders, crane-mounted electromagnets and claw-like grapples.

Shearing or Cutting - Pieces of oversized ferrous scrap material, such as obsolete steel girders and used pipe, which are too large for other processing are cut with hand torches, crane-mounted alligator shears or stationary guillotine shears.

Baling - We process light-gauge ferrous materials such as clips, sheet iron and by-products from industrial and commercial processes, such as stampings, clippings and excess trimmings, by baling these materials into large, uniform blocks. We use cranes and conveyors to feed the material into a hydraulic press, which compresses the material into uniform blocks.

Ferrous Scrap Sales - We sell processed ferrous scrap material to end-users such as steel mini-mills, integrated steel makers and foundries, and brokers who aggregate materials for other large users. Most customers purchase processed ferrous scrap material through negotiated spot sales contracts, which establish the quantity purchased for the month and the pricing. The price we charge for ferrous scrap materials depends upon market supply and demand, as well as quality and grade of the scrap material.

Non-Ferrous Operations

Non-Ferrous Scrap Purchasing - We purchase non-ferrous scrap from two primary sources: (i) industrial and commercial non-ferrous scrap material providers who generate or sell waste aluminum, copper, stainless steel, other nickel-bearing metals, brass and other metals; and (ii) peddlers, scrap dealers, generators and collectors who deliver directly to our facilities material that they collect from a variety of sources. We also collect non-ferrous scrap from sources other than those that are delivered directly to our processing facilities by placing retrieval boxes at these sources. The boxes are subsequently transported to our processing facilities.

Non-Ferrous Scrap Processing - We prepare non-ferrous scrap metals, principally aluminum, copper, brass and stainless steel to sell by sorting, shearing, cutting or baling.

Sorting - Our sorting operations separate and identify non-ferrous scrap by using front-end loaders, grinders, hand torches and spectrometers. Our ability to identify metallurgical composition maximizes margins and profitability. We sort non-ferrous scrap material for further processing according to type, grade, size and chemical composition. Throughout the sorting process, we determine whether the material requires further processing before we sell it.

Shearing or Cutting - Pieces of oversized non-ferrous scrap material, which are too large for other processing methods, are cut with alligator shears.

Baling - We process non-ferrous metals such as aluminum cans, sheet and siding by baling these materials into large uniform blocks. We use front-end loaders and conveyors to feed the material into a hydraulic press, which compresses the material into uniform blocks.

Non-Ferrous Scrap Sales - We sell processed non-ferrous scrap material to end-users such as foundries, aluminum sheet and ingot manufacturers, copper refineries and smelters, and brass and bronze ingot manufacturers. Prices for the majority of non-ferrous scrap materials change based upon the daily publication of spot and futures prices on COMEX or the London Metals Exchange.

Management Services Operations -- Computerized Waste Systems (CWS)

Our management services operations are in the business of commercial, retail and industrial waste and recycling management services. CWS offers a "total package" concept to commercial, retail and industrial customers for their waste and recycling management needs. Combining waste reduction and diversion, and waste equipment technology, CWS creates waste and recycling programs tailored to each customer's needs. The services we offer include locating and contracting with a hauling company and recycler at a reasonable cost for each participating location. CWS does not own waste-transporting trucks or landfills. We do not operate or partner with any of the national hauling or recycling companies, and none of these companies own us. We are able to maintain a neutral position for the benefit of our customers. We have designed and developed proprietary computer software that provides our personnel with relevant information on each customer's locations, as well as pertinent information on service providers, disposal rates, costs of equipment, including installation and shipping, disposal rates and recycling prices. This software has allowed us to build a database for serving our customers that have locations nationwide as well as Canada and Mexico. This software enables us to generate detailed monthly customized billing reports, and price tracking to accommodate our customers' needs.

Our management services division provides our customers evaluation, management, monitoring, auditing and cost reduction of non-hazardous solid waste removal and recycling activities. CWS has developed a network of over 2,300 hauling, landfill, recycling and equipment manufacturing and maintenance service providers throughout the United States and Canada. Through this network, we are able to provide pricing estimates for current and potential customers. CWS customer service representatives have access to this information through the computer software designed and developed to enhance the value offered to our customers. Through this information retrieval system and database, customer service representatives can review the accuracy of recent billings for hauling, landfill and recycling rates.

Prior to the expiration of the Home Depot contract on October 30, 2005, we derived a significant portion of our revenues from Home Depot, accounting for approximately 56% of 2005 and 51% of 2004 total revenues. The impact to our gross profit was limited to 24% in 2005 and 23% in 2004.

Waste and Recycling Equipment Sales and Services Operations-WESSCO-Waste and Sales Service Company

Our waste equipment sales and services operation, WESSCO, is in the business of commercial and industrial waste and recycling handling equipment sales, rental and maintenance. By offering competitively priced waste and recycling handling equipment from a number of different manufacturers, we are able to tailor equipment packages for individual customer needs. We do not manufacture any equipment, but we do refurbish, recondition and add options when necessary. We sell, rent and repair all types of industrial and commercial waste and recycling handling equipment such as compactors, balers and containers.

"Total Package" Concept

We record revenues and costs in the period of delivery. Our management services division has third party service providers providing same day service for all waste removal and recycling services for our customers. Our recycling division purchases ferrous and nonferrous materials, cardboard and paper on a daily basis. We record these purchases in the period received. We record revenue and cost in the period of delivery. The products or services have value to the customer on a standalone basis. These services make up the "total package" concept.

Company Background

ISA was incorporated in October 1953 in Florida under the name Alson Manufacturing, Inc. From the date of incorporation through January 5, 1975, Alson designed and manufactured various forms of electrical products. In 1979, the Board of Directors and the shareholders of Alson commenced liquidation of all the tangible assets of Alson. On October 27, 1983, Harry Kletter, our Chairman of the Board and Chief Executive Officer, acquired 419,500 shares of ISA Common Stock. The existing directors resigned and five new directors were elected.

On July 1, 1984, we began a solid waste handling and disposal equipment sales organization under the name Waste Equipment Sales and Services Company, which we refer to as WESSCO. On January 1, 1985, we merged with Computerized Waste Systems, Inc., a Massachusetts corporation. CWS was a corporation specializing in offering solid waste management consultations for large multi-location companies involved in the retail, restaurant and industrial sectors. At the time of the merger, CWS was concentrating on large retail chains, but has changed its emphasis to include commercial and industrial customers. This strategy created an additional target market for us. Subsequent to the merger with CWS, we moved the CWS headquarters from Springfield, Massachusetts to Louisville, Kentucky. At the time of the merger, much of the customer base and marketing efforts were concentrated in the Northeast. With the move to Louisville, we began to expand its marketing efforts, which are now nationwide as well as Canada.

On July 1, 1997, we acquired the assets of a non-ferrous scrap metal recycling facility located at 7100 Grade Lane, Louisville, Kentucky, thus expanding our recycling product lines.

In January 1998, we acquired the business of a ferrous scrap and corrugated paper recycling facility located at 7100 Grade Lane, Louisville, Kentucky. This acquisition was the beginning of our ferrous scrap metal, non-ferrous scrap metal and corrugated paper processing segment known as ISA Recycling.

On June 1, 1998, we acquired all of the business, property, rights and assets of a ferrous and non-ferrous scrap metal recycling facility located in North Vernon, Indiana. On July 8, 2002, we acquired a five-acre tract at 1565 East 4th Street, Seymour Indiana. In the fourth quarter of 2002, we moved our metal recycling facilities from North Vernon, Indiana to Seymour, Indiana.

On February 15, 2005 we added a location in Lexington, Kentucky. We are using this property as a transfer station for ferrous and nonferrous material. There are no processing operations at this facility. We have discontinued operations in this facility during the first quarter of 2007 and are now subleasing the property to an unaffiliated third party.

Industry Background

Our operations primarily involve the collection and processing of ferrous and non-ferrous scrap metals. We collect industrial scrap metal and obsolete scrap metal, process it into reusable forms and supply the recycled scrap metals to our customers.

We manage non-hazardous solid waste and recyclables for retail, commercial and industrial customers. As such, the multi-billion dollar solid waste collection and disposal business drives the industry. The size of this industry has increased for the past several years and should continue to increase as landfill space decreases. Although society and industry have developed an increased awareness of environmental issues and recycling has increased, waste production also continues to increase. Because of environmental concerns, new regulations and cost factors, it has become difficult to obtain the necessary permits to build any new landfills. Management believes that with the consolidation taking place in the waste industry, it will become increasingly difficult for a customer to receive a fair price. We are, therefore, in a position to represent the best interest of the customer; this fact can only enhance our business.

In addition to increasing landfill costs, regulatory measures and more stringent control of material bound for disposal ("flow control") are making the management of solid waste an increasingly difficult problem. The United States Environmental Protection Agency is expected to continue the present trend of restricting the amount of potentially recyclable material bound for landfills. Many states have passed, or are contemplating, measures that would require industrial and commercial companies to recycle a minimum percentage of their waste stream and restrict the percentage of recyclable materials in any commercial load of waste material. Many states have already passed restrictive regulations requiring a plan for the reduction of waste or the segregation of recyclable materials from the waste stream at the source. ISA management believes that these restrictions may create additional marketing opportunities as waste disposal needs become more specialized. Some large industrial and commercial companies have hired in-house staff to handle the solid waste management and recycling responsibilities, but have found that without adequate resources and staff support, in-house handling of these responsibilities may not be an effective alternative. We offer these establishments a solution to this increasing burden.

Competition

On a commercial/industrial waste management level, we have competition from a variety of sources. Much of it is from companies that concentrate their efforts on a regional level. We believe that with the proprietary database of regional and national pricing, we will maintain our edge on a national basis.

There has been increased competition from national hauling and recycling companies. The large national hauling and recycling companies often attempt to handle all locations for a "national chain" customer. This scenario poses a potential conflict of interest since these hauling companies and recyclers can attain greater profitability from increases in hauling and disposal revenues and fluctuations in recycling prices. In addition to having an interest in higher hauling and disposal rates, the national hauling companies do not have operations in every community. Additionally, we have encountered evidence of some reluctance from independent hauling and recycling companies to work with national hauling and recycling companies for locations not serviced by these national companies.

There is also competition from some equipment manufacturers. The primary interest of these companies is selling, leasing and renting equipment and offering management services in order to secure these sales or leases. There is a cost involved in using the equipment and the money saved must justify the amount spent on this equipment.

The metal recycling business is highly competitive and is subject to significant changes in economic and market conditions. Certain ISA competitors have greater financial, marketing and physical resources. There can be no assurance that we will be able to obtain our desired market share based on the competitive nature of this industry.

An important difference between us and the majority of our competition is our management process. Our systematic approach attempts to provide consistent results for the customer. At the implementation stage, we actively bid out every location that a new customer requests. We repeat this bidding process any time a customer receives notice of an undocumented price increase or at regular intervals as indicated in the contract. At subsequent stages, we will evaluate a customer's solid waste and recycling program and provide alternatives for improvement.

We have developed a network of maintenance, hauling, disposal, equipment and recycling companies throughout the country and in Canada, and due to the volume of business we have awarded to them, these companies will often offer us discounted hauling, disposal and maintenance rates and increased recycling prices. However, no company or service provider in the hauling, disposal, recycling, equipment and/or maintenance industries owns or controls us. We deal with those companies and service providers that can supply quality service and products at a favorable price and understand that as long as we serve our customers well, we and our service providers will have the opportunity to bid on future accounts.

Few, if any, of our competitors have a national network of service providers similar to the one we have developed over our years of operation. Although the major hauling and recycling companies have operating companies in most major and intermediate-sized cities, they do not have nationwide geographic coverage. Therefore, for large commercial and industrial clients, they must obtain bids from local hauling, disposal and recycling companies that may perceive them to be future competitors. We have positioned ourselves to negotiate with the haulers, landfill operators and recyclers while servicing our customers on a nationwide basis.

Employees

As of December 31, 2006, ISA had one hundred and two (102) full-time employees as follows: recycling 69, management services 16, sales/leasing 4 and administration/information technology 13. None of our employees is a member of a union.

Effect of State and Federal Environmental Regulations

Any environmental regulatory liability relating to our operations is generally borne by the customers with whom we contract and the service providers in their capacity as transporters, disposers and recyclers. Our policy is to use our best efforts to secure indemnification for environmental liability from our customers and service providers. Although we believe that our business does not subject us to potential environmental liability, we continue to use our best efforts to be in compliance with federal, state and local environmental laws, including but not limited to the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, the Hazardous Materials Transportation Act, as amended, the Resource Conservation and Recovery Act, as amended, the Clean Air Act, as amended, and the Clean Water Act. Such compliance has not historically constituted a material expense to us.

The collection and disposal of solid waste and rendering of related environmental services as well as recycling operations and issues are subject to federal, state and local requirements, which regulate health, safety, the environment, zoning and land-use. Federal, state and local regulations vary, but generally govern hauling, disposal and recycling activities and the location and use of facilities and also impose restrictions to prohibit or minimize air and water pollution. In addition, governmental authorities have the power to enforce compliance with these regulations and to obtain injunctions or impose fines in the case of violations, including criminal penalties. The EPA and various other federal, state and local environmental, health and safety agencies and authorities, including the Occupational Safety and Health Administration of the U.S. Department of Labor administer those regulations.

We strive to conduct our operations in compliance with applicable laws and regulations. While such amounts expended in the past or that we anticipate spending in the future have not had and are not expected to have a material adverse effect on our financial condition or operations, the possibility remains that technological, regulatory or enforcement developments, the results of environmental studies or other factors could materially alter this expectation.

Each state in which we operate has its own laws and regulations governing solid waste disposal, water and air pollution and, in most cases, releases and cleanup of hazardous substances and liability for such matters. Several states have enacted laws that will require counties to adopt comprehensive plans to reduce, through waste planning, composting, recycling, or other programs, the volume of solid waste landfills. Several states have recently enacted these laws. Legislative and regulatory measures to mandate or encourage waste reduction at the source and waste recycling also are under consideration by Congress and the EPA.

Finally, various states have enacted, or are considering enacting, laws that restrict the disposal within the state of solid or hazardous wastes generated outside the state. While courts have declared unconstitutional laws that overtly discriminate against out of state waste, courts have upheld some laws that are less overtly discriminatory. Challenges to other such laws are pending. The outcome of pending litigation and the likelihood that jurisdictions will adopt other such laws that will survive constitutional challenge are uncertain.

ITEM 1A. Risk Factors

Risk Factors

This Annual Report on Form 10-K includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, including, in particular, certain statements about our plans, strategies and prospects. Although we believe that our plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, we cannot assure you that such plans, intentions or expectations will be achieved. Important factors that could cause our actual results to differ materially from our forward-looking statements include those set forth in this Risk Factors section. All forward-looking statements attributable to us or any persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth below. Unless the context requires otherwise, all references to the "company," "we," "us" or "our" include Industrial Services of America, Inc. and subsidiaries.

If any of the following risks, or other risks not presently known to us or that we currently believe to not be significant, develop into actual events, then our business, financial condition, results of operations, cash flows or prospects could be materially adversely affected.

Risks Related to Our Operations

Our business has increasing involvement in ferrous, non-ferrous and fiber recycling. Currently, the prices of metals are high, but changes in demand, including foreign demand, regulation, economic slowdowns or increased competition could result in a reduction of our revenue and consequent decrease in our common stock price.

Many companies offer or are engaged in the development of products or the provisions of services that may be or are competitive with our current products or services, although we do not believe any competition offers the unique mixture of the services and products we provide in the waste management area. Many entities have substantially greater financial, technical, manufacturing, marketing, distribution and other resources than we possess. In addition, the industry is constantly changing as a result of consolidation that may create additional competitive pressures in our business environment.

An increase in the price of fuel may adversely affect our business.

Our operations are dependent upon fuel, which we generally purchase in the open market on a daily basis. Direct fuel costs include the cost of fuel and other petroleum-based products used to operate our fleet of cranes and heavy equipment. We are also susceptible to increases in indirect fuel costs which include fuel surcharges from vendors. During 2004, 2005 and 2006, we experienced increases in the cost of fuel and other petroleum-based products. A portion of these increases we passed on to our customers. However, because of the competitive nature of the industry, there can be no assurance that we will be able to pass on current or future increases in fuel prices to our customers. Due to political instability in oil-producing countries, fuel prices may continue to increase in 2007. A significant increase in fuel costs could adversely affect our business.

We could incur substantial costs in order to comply with, or to address any violations under, environmental laws that could significantly increase our operating expenses and reduce our operating income.

Our operations are subject to various environmental statutes and regulations, including laws and regulations addressing materials used in the processing of our products. In addition, certain of our operations are subject to federal, state and local environmental laws and regulations that impose limitations on the discharge of pollutants into the air and water and establish standards for the treatment, storage and disposal of solid and hazardous wastes. Failure to maintain or achieve compliance with these laws and regulations or with the permits required for our operations could result in substantial operating costs and capital expenditures, in addition to fines and civil or criminal sanctions, third party claims for property damage or personal injury, cleanup costs or temporary or permanent discontinuance of operations. Certain of our facilities have been in operation for many years and, over time, we and other predecessor operators of these facilities have generated, used, handled and disposed of hazardous and other regulated wastes. Environmental liabilities could exist, including cleanup obligations at these facilities or at off-site locations where materials from our operations were disposed of, which could result in future expenditures that cannot be currently quantified and which could reduce our profits.

Our financial statements are based upon estimates and assumptions that may differ from actual results.

We have prepared our financial statements in accordance with U.S. generally accepted accounting principles and necessarily include amounts based on estimates and assumptions we made. Actual results could differ from these amounts. Significant items subject to such estimates and assumptions include the carrying value of long-lived assets, valuation allowances for accounts receivable, liabilities for potential litigation, claims and assessments, and liabilities for environmental remediation and deferred taxes.

We depend on our senior management team and the loss of any member could prevent us from implementing our business strategy.

Our success is dependent on the management and leadership skills of our senior management team. We have not entered into employment agreements with any of our senior management personnel. The loss of any members of our management team or the failure to attract and retain additional qualified personnel could prevent us from implementing our business strategy and continuing to grow our business at a rate necessary to maintain future profitability.

Seasonal changes may adversely affect our business and operations.

Our operations may be adversely affected by periods of inclement weather which could decrease the collection and shipment volume of recycling materials.

Risks Related to Our Common Stock

Future sales of our common stock could depress our market price and diminish the value of your investment.

Future sales of shares of our common stock could adversely affect the prevailing market price of our common stock. If our existing shareholders sell a large number of shares, or if we issue a large number of shares, the market price of our common stock could significantly decline. Moreover, the perception in the public market that our existing shareholders and in particular members of the Kletter family might sell shares of common stock could depress the market for our common stock.

The market price for our common stock may be volatile.

In recent periods, there has been volatility in the market price for our common stock. In addition, the market price of our common stock could fluctuate substantially in the future in response to a number of factors, including the following:

- our quarterly operating results or the operating results of our companies in the waste management or ferrous, non-ferrous and fiber recycling industry;
- changes in general conditions in the economy, the financial markets or the ferrous, non-ferrous and fiber recycling industry;
- loss of significant customers, as was the case with the loss of Home Depot; and
- increases in materials and other costs.

In addition, in recent years the stock market has experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated to their operating performance. These broad market fluctuations may materially adversely affect our stock price, regardless of our operating results.

Item 2. Properties.

Related Parties Agreements -- K&R

On February 16, 1998 our Board of Directors ratified and formalized an existing relationship in connection with (i) our leasing of facilities from K&R, LLC and (ii) the provision of consulting services from K&R to us. K&R is our affiliate because our Chief Executive Officer is our principal shareholder and he owns 100% of K&R.

Lease Agreement. This K&R lease, effective as of January 1, 1998, covers approximately 20.5 acres of land and the improvements thereon, which are located at 7100 Grade Lane in Louisville, Kentucky. The principal improvements consist of the following:

- an approximately 22,750 square foot building used as the corporate and CWS offices;
- an approximately 8,286 square foot building used for sales/leasing and information technology offices;
- an approximately 13,995 square foot building used as the paper recycling plant;
- an approximately 12,000 square foot building used for the metals recycling plant;
- an approximately 51,760 square foot building used as the recycling offices and warehouse space;
- and the remaining 15,575 square feet of space contained in five (5) buildings ranging in size from approximately 256 to 8,000 square feet.

The initial term of the K&R lease is for ten years with two five-year option periods available thereafter. The base rent for the first five years was $450,000 per annum. The rent for the second five years, beginning January 1, 2003, became $505,272 per annum, payable at the beginning of each month in an amount equal to $42,106. This fixed minimum rent adjusts each five years, including for each of the option periods, in accordance with the consumer price index. The fixed minimum rent also increases to $750,000 per annum, in an amount equal to $62,500 per month in the event of our change in control. We must pay, as additional rent, all real estate taxes, insurance, utilities, maintenance and repairs, replacements (including replacement of roofs if necessary) and other expenses. The K&R lease provides for our indemnification of K&R for all damages arising out of our use of or the condition of the leased premises excepting from K&R's negligence.

In 2004, we paid for repairs totaling $302,160 that we made to the buildings and property that we lease from K&R, located at 7100 Grade Lane, Louisville, Kentucky. K&R executed an unsecured promissory note, dated March 25, 2005 but effective December 31, 2004, to us for the principal sum of $302,160. K&R makes payments on the promissory note of principal and interest in ninety-six (96) monthly installments of $3,897.66. The rate of interest is five and one-half percent (5.5%) per annum. Failure of K&R to make any payment when due under this note within fifteen (15) days of its due date shall constitute a default. After the fifteen day period, the note shall bear interest at a rate equal to fifteen percent (15%) per annum and we have the right to exercise our remedies to collect full payment of the note.

In an addendum to the K&R lease as of January 1, 2005, the rent was increased $4,000 as a result of the improvements made to the property in 2004. For years 2005 and 2006, our payments to K&R of $4,000 for additional rent and the payment from K&R of $3,897.66 for the promissory note were offset.

K&R Consulting Agreement. The K&R consulting agreement remains in effect until December 31, 2007, with automatic annual renewals thereafter unless one party provides written notice to the other party of its intent not to renew at least six months in advance of the next renewal date. K&R shall provide strategic planning for mergers and acquisitions. We are responsible for all of K&R's expenses and pay to K&R $240,000 in equal monthly installments of $20,000 in connection with the K&R consulting activities.

The K&R consulting agreement terminates upon a non-defaulting party providing written notice to the other party of its intent to terminate. The recipient of the notice has 10 days to cure monetary defaults and 30 days to cure non-monetary defaults. Upon termination, K&R agrees not to engage, directly or indirectly, in the business conducted by, or hire our employees for a period of five years and within 100 miles of any of our operations.

We compensate our principal shareholder and Chief Executive Officer through consulting fees paid pursuant to the K&R consulting agreement.

Lease and Sublease Agreements -- Lexington

We have subleased the Lexington property to an unaffiliated third party for a term commencing March 1, 2007 and ending December 31, 2012 for $4,500 per month. We currently lease this property from an unrelated party for $4,500 per month; the lease terminates December 31, 2012. If for any reason the sublessee defaults, we remain liable for the remainder of the lease payments through December 31, 2012.

Lease Agreement -- Pineville, Louisiana

On February 6, 2007, we leased 7.7 acres of real property, including a 38,000 square foot warehouse and a 400 square foot office, in Pineville, Louisiana for $5,250 per month for twenty-four months beginning March 1, 2007 and ending February 28, 2009, with an option to purchase the property for a purchase price of $575,000.

Item 3. Legal Proceedings.

Effective as of May 5, 2006, we entered into an agreement with Andrew M. Lassak to settle Mr. Lassak's claims against us in Lassak v. Industrial Services of America, Inc., et al, No. 04-423-CA (Fla. 19th Cir. Ct. filed June 2, 2004). Lassak's demands and claims included rights to purchase 240,500 shares of our common stock for $1.25 per share, rights to purchase 149,500 shares of our common stock for $3.00 per share, and demand and piggyback registration rights as well as cashless exercise rights with respect to such options. Since the inception of the suit, we had disputed Lassak's claims and had denied any liability for Lassak's claims and demands. Pursuant to the settlement agreement, we allowed Lassak to exercise a reduced number of the options he was seeking -- 40,000 at an exercise price of $1.25 per share. Lassak tendered to us the full exercise price for the 40,000 options and we filed a registration statement for the underlying shares with the Securities and Exchange Commission on May 24, 2006. The registration was declared effective by the Securities and Exchange Commission on June 12, 2006. We then delivered 40,000 registered shares to Lassak, thereby satisfying all our requirements under the settlement agreement and effectively concluding this matter.

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

None.

Item 4a. ISA Executive Officers.

Name	Served as an Executive Officer From	Age	Position with the Registrant and Other Principal Occupations
Harry Kletter	1983	80	ISA Chairman of the Board and Chief Executive Officer from May 2, 2000 to present. ISA Chairman of the Board and Chief Visionary Officer from February 3, 2000 to May 2, 2000. Mr. Kletter served as Chairman of the Board and Chief Executive Officer from July 31, 1992 to February 3,

			2000, President of ISA from July 31, 1992 to December 1997, from January 1990 to July 1991, and from October 1983 to January 1988; Mr. Kletter is also Chairman and sole shareholder of K&R, LLC.
Alan L. Schroering	2000	42	ISA Chief Financial Officer since May, 2001. Mr. Schroering served as an ISA board member from June 2000 to May 2001. Mr. Schroering has served as Treasurer from October 2001 to present. Mr. Schroering served in several accounting positions with National Processing Company from April 1998 to May 2000. Mr. Schroering served previously in several accounting positions with ISA from November 1984 to March 1998.
Ed List	June 2005 - December 2006	61	ISA Chief Operating Officer from June 1, 2004 to December 31, 2006. He served previously as Vice President/Senior Accounts Manager CWS for ISA from May 2000 to June 2004.
Bob Cuzzort	January 2006 - June 2006	58	ISA Executive Vice President, Corporate Operations from January 2005 to June 22, 2006. ISA Chief Operating Officer from July 2001 to April 2003. Director of Human Resources from March 2001 to April 2003. He served previously in charge of special projects for ISA from October 2000 to March 2001. Mr. Cuzzort served as general manager of Bassett Furniture Direct from March 1998 to August 2000. He served in several management positions with Haverty Furniture Company, Inc. from January 1970 to February 1998.
Michael P. Shannonhouse	April 2005 - August 2006	30	ISA Secretary from April 16, 2004 through August 10, 2006. Served as acting ISA Secretary from October 20, 2003 to April 16, 2004, and ISA Director of Legal Affairs from October 20, 2003 to August 10, 2006. Prior to accepting his position with ISA, Mr. Shannonhouse worked as a law clerk in private practice from 2002 to 2003. Mr. Shannonhouse is employed with Atherton & Associates, a law firm in Louisville, Kentucky, and performs legal services for us through this firm. Mr. Shannonhouse is acting as a recording secretary for the ISA Board meeting minutes.

None of the above officers is related to any other except that Mr. List is the son-in-law of Mr. Kletter. With respect to certain arrangements with certain officers of ISA relating to executive compensation, see section entitled "Executive Compensation - Certain Transactions" in ISA's Proxy Statement for the 2007 Annual Meeting of Shareholders as incorporated herein by reference at Item 11.

PART II

Item 5. Market for ISA's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Effective August 29, 1996, the $.01 par value ISA common stock became listed on the Small Cap Market (the "Small Cap Market") of the NASDAQ Stock Market under the symbol "IDSA." Prior to August 29, 1996, our common stock traded on the Over the Counter Bulletin Board operated by the National Association of Securities Dealers, Inc. High and low sales price of the common stock price is summarized as follows:

Quarter Ended	2006		2005		2004	
	High	Low	High	Low	High	Low
March 31	$ 5.20	$3.22	$ 7.50	$5.94	$23.75	$2.06
June 30	$ 8.00	$4.82	$ 6.10	$3.70	$21.50	$9.91
September 30	$ 6.31	$5.58	$ 6.60	$3.69	$14.89	$5.68
December 31	$ 6.72	$5.26	$ 3.70	$2.85	$13.36	$7.60

There were approximately 383 shareholders of record as of December 31, 2006.

On February 26, 2004, we approved a two for one stock split distributed on March 30, 2004 to shareholders of record on March 16, 2004. The stock split required retroactive restatement of all historical share and per share data.

Until August 8, 2000, we had always had a policy intending that we would retain earnings to help finance our expansion programs. On August 8, 2000, our Board of Directors approved a change in the dividend policy whereby our Board of Directors could declare dividends, which we did declare and pay on one occasion in the amount of $.10 per share on September 21, 2004. Our Board of Directors has the discretionary power to declare dividends within the constraints of our loan agreement with the Branch Banking and Trust Company.

On November 15, 2005, our Board of Directors authorized a new program to repurchase up to 200,000 shares of our common stock at current market prices. In 2006 we repurchased 5,509 shares and in 2005 we repurchased 10,000 shares. We repurchased 673,400 shares of our common stock in a prior stock repurchase program that began in August 2000.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as part of Publicly Announced Plans or Programs	Maximum Number of Shares that may yet be Purchased Under the Plans or Programs
Oct-05	-			
Nov-05	10,000	$ 2.9762	10,000	190,000
Dec-05	-			
Jan-06	5,509	$2.9658	15,509	184,491

The following performance graph compares the performance of ISA's Common Stock to the Standard & Poors 500 and to a peer group for the period commencing December 2001. Since there is no nationally recognized industry index consisting of consultants in the business of retail and industrial waste management sales and service of waste handling equipment to be used as a peer group index, ISA constructed its own peer group. This peer group is comprised of four companies which represent the other public companies in the industry -- Casella Waste Systems, Inc., Republic Services, Inc., Waste Connections, Inc., and Waste Holdings, Inc. The returns of each member of the peer group are weighted according to each member's stock market capitalization as of the beginning of the period measured. The graph assumes that the value of the investment in ISA's Common Stock and each index was $100 at December 2001 and that all dividends were reinvested.

	12/01	12/02	12/03	12/04	12/05	12/06
Industrial Services Of America, Inc.	100.00	95.69	206.22	762.23	300.24	528.08
S & P 500	100.00	77.90	100.24	111.15	116.61	135.03
Peer Group	100.00	105.59	125.92	165.05	180.23	206.95

Item 6. Selected Financial Data.

Selected Financial Data

2006		2005	2004	2003	(2,746,236)
$	(2,666,236)				

The following table summarizes the estimated fair values of IceWeb Virginia s assets and liabilities disposed of at the date of the sale:

Intangible assets, net	$	(53,565)
IceWEB, Inc. common stock		(80,000)
Accounts payable and accrued liabilities		2,799,801
Estimated gain on the sale	$	2,666,236

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

The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and with the instructions to Securities and Exchange Commission (SEC) Form 10-Q and Article 10 of SEC Regulation S-X. Accordingly, they do not include all the information and footnote disclosures required by GAAP for complete financial statements. For further information, these financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company s Annual Report on Form 10-K (File No. 000-27865) for the year ended September 30, 2010 (Form 10-K).

The unaudited consolidated financial statements contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to state fairly the Company s consolidated financial position at December 31, 2010, and the consolidated results of its operations for the three months ended December 31, 2010 and 2009, and the consolidated cash flows for the three months ended December 31, 2010 and 2009. The results of operations for the three months ended December 31, 2010 are not necessarily indicative of the results to be expected for the full year.

The consolidated balance sheet at September 30, 2010 has been derived from the audited consolidated financial statements at that date but does not include all footnote disclosures required by GAAP.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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The Company s significant accounting policies are disclosed in the Company s Form 10-K. The Company has evaluated subsequent events through February 15, 2011, the date the Company filed its Quarterly Report on Form 10-Q for the quarter ended December 31, 2010.

Fiscal Year

The fiscal year ends on September 30. References to fiscal 2011, for example, refer to the fiscal year ending September 30, 2011.

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.

Reclassifications

Certain reclassifications have been made to previously reported amounts to conform to 2011 amounts. The reclassifications had no impact on previously reported results of operations or shareholders deficit.

Going Concern

Our auditors stated in their report on the consolidated financial statements of the Company for the Years ended September 30, 2010 and 2009 that 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 6, we are not in compliance with debt covenants under our Financing Agreements with Sand Hill Finance LLC. For the year ended September 30, 2010 we incurred a net loss of $6,964,233. 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.

Fair value of financial instruments

The carrying amounts of financial instruments, including cash, accounts receivable, prepaid expenses, and other current assets, accounts payable and accrued liabilities, and deposits approximated fair value as of September 30, 2010 and 2009, because of the relatively short-term maturity of these instruments and their market interest rates.

Marketable Securities

IceWEB accounts for the purchase of 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. However, those securities may not have the trading volume to support the stock price if the Company were to sell all their shares in the open market at once, so the Company may have a loss on the sale of marketable securities even though they record marketable equity securities at the current market value. Due to the illiquid nature of the marketable securities that IceWEB owns we applied a discount factor of 20% to the fair value of the marketable security.

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 2010 and 2009 include the allowance for doubtful accounts, the valuation of stock-based compensation, the allowance for inventory obsolescence and the useful life of property and equipment and intangible assets, and litigation reserves.

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ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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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, 2010. Management performs ongoing evaluations of its accounts receivable. Management believes that all remaining receivables are fully collectable. Bad debt expense amounted to $100,691 and $0 for the three months ended December 31, 2010 and 2009, respectively.

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 is provided by using the straight-line method over the estimated useful lives of the related assets.

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 estimated useful life of our acquired customer relationships is five years.

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 $60,806 and $16,456 for the three months ended December 31, 2010 and 2009, respectively.

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.

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.

ICEWEB, INC. AND SUBSIDIARIES

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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 September 30, 2010, there were options and warrants to purchase 19,891,504 shares of common stock, 626,667 shares issuable upon conversion of Series B preferred stock, and no shares of Series C preferred stock outstanding which could potentially dilute future earnings per share.

Stock-Based Compensation

As more fully described in Note 12, 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 2000 Management and Director Equity Incentive and Compensation Plan (the Plan).

Prior to October 1, 2005, we 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 ASC Topic 718, Compensation Stock Compensation (Formerly SFAS No. 123 (R), Share-Based Payments. No stock-based compensation cost related to employee stock options was recognized in the Consolidated Statement of Operations for the year ended September 30, 2005 as all options granted under the Plan had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective October 1, 2005, we adopted the fair value recognition provisions of ASC Topic 718, Compensation Stock Compensation (Formerly SFAS No. 123 (R), Share-Based Payments using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the year ended September 30, 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of September 30, 2005, 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). Financial results for the year ended September 30, 2005 have not been restated.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, Improving Disclosures about Fair Value Measurements (ASU 2010-06). This update requires additional disclosure within the roll forward of activity for assets and liabilities measured at fair value on a recurring basis, including transfers of assets and liabilities between Level 1 and Level 2 of the fair value hierarchy and the separate presentation of purchases, sales, issuances and settlements of assets and liabilities within Level 3 of the fair value hierarchy. In addition, the update requires enhanced disclosures of the valuation techniques and inputs used in the fair value measurements within Levels 2 and 3. The new disclosure requirements were effective for interim and annual periods beginning after December 15, 2009 (the adoption of which did not have an impact on the Company s financial statements), except for the disclosure of purchases, sales, issuances and settlements of Level 3 measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 (September 1, 2011 for the Company). As ASU 2010-06 only requires enhanced disclosures, the Company does not expect that the adoption of this update will have a material effect on its financial statements.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 3 - PROPERTY AND EQUIPMENT

Property and equipment, net, consists of the following:

	Estimated Life	December 31, 2010	September 30, 2010
Office equipment	5 years	$ 715,002	$ 699,282
Computer software	3 years	612,379	612,379
Furniture and fixtures	5 years	261,385	261,385
Leasehold improvements	2 - 5 years	1,026,470	1,026,470
		2,615,236	2,599,516
Less: accumulated depreciation		(2,286,488)	(2,180,643)
		$ 328,748	$ 418,873

Depreciation expense for the three months ended December 31, 2010 and 2009 was $105,845 and $106,701 respectively.

NOTE 4 - INVENTORY

Inventory consisted of the following:

	December 31, 2010	September, 30, 2010
Raw materials	$ 85,674	$ 49,757
Work in progress	16,064	9,330
Finished goods	5,355	3,110
	$ 107,093	$ 62,197

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, 2009, the principal amount due under the Financing Agreement amounted to $1,726,993.

In November, 2008, in connection with the term note the Company executed a convertible debenture agreement with Sand Hill Finance, LLC in the amount of $1,170,767. The debenture bears interest at 18% and will allow Sand Hill Finance, LLC to convert the outstanding obligation into shares of IceWEB common stock at a fixed floor conversion price of $0.30 per share. The principal amount due under the convertible debenture amounted to $967,884 at December 31, 2009.

Interest on the accounts receivable-based borrowings is payable at a rate of 1.75% per month on the average loan balance outstanding during the year, equal to an annual interest of approximately 21% 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

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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 prices $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.

Third party guarantee - In November 2006, the Company sold its interest in one of its subsidiaries (Integrated Power Solutions, Inc. or IPS) to a shareholder of the Company and related party. IPS is a party to the Financing Agreement and can borrow against receivables transferred to Sand Hill Finance, LLC under the terms of the Financing Agreement. The Company remains liable for any such amounts borrowed under the Financing Agreement by IPS which is no longer under the Company s control. To date, IPS has not borrowed any funds under the Financing Agreement.

In August, 2008, the Company borrowed $187,500 from an accredited investor. The note bears interest at 16% and had a term of four months, and can be repaid in either cash or IceWEB common stock. As of December 31, 2008 the Company had repaid the full amount of the note through the sale of 2,226,101 shares of Iceweb common stock.

NOTE 6 - CONCENTRATION OF CREDIT RISK

Bank Balances

The Company maintains its cash bank deposits at various financial institutions which, at times, may exceed federally insured limits. Accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to $250,000. At December 31, 2010, the Company had no balances in excess of FDIC insured limits. The Company has not experienced any losses in such accounts.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 7 - INVESTMENTS

(a) Summary of Investments

Marketable Equity Securities:

As of December 31, 2010, the Company s investments in marketable equity securities are based on the December 31, 2010 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, 2010	**Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Publicly traded equity securities	$ 48,000	$ 3,840	$	$ 51,840
Total	$ 48,000	$ 3,840	$	$ 51,840

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

(b) Gains and Losses on Investments

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

	Three Months Ended December 31,			
		2010		2009
Net losses on investments in publicly traded equity securities	$	(472,960)	$	
Net losses on investments	$	(472,960)	$	

On January 1, 2008, the Company adopted ASC 820, which, among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. The Company did not adopt the ASC 820 fair value framework for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements at least annually. ASC 820 clarifies that fair value is an exit price, representing the amount that would either be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1. Observable inputs such as quoted prices in active markets for identical assets or liabilities;

Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

ICEWEB, INC. AND SUBSIDIARIES

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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)**
Marketable Equity Securities, net of discount for effect of restriction	$	$	$ 51,840

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.

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, 2010 the guidance in ASC 320, the Investment-Debt and Equity Securities, is carefully followed.

There were no impairment charges on investments in publicly traded equity securities for the three months ended December 31, 2010 or 2009.

The Company has evaluated its publicly traded equity securities as of September 30, 2010, 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 8 - COMPREHENSIVE INCOME (LOSS)

Comprehensive income is comprised of net income 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 other comprehensive income consists of unrealized gains on marketable securities available for sale of $3,840.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 9 - STOCKHOLDERS DEFICIT

Common Stock Warrants

A summary of the status of the Company s outstanding common stock warrants as of December 31, 2010 and changes during the period ending on that date is as follows:

	Number of Warrants		Weighted Average Exercise Price
Common Stock Warrants			
Balance at beginning of year	8,287,100	$	0.40
Granted			
Exercised			
Forfeited			
Balance at end of period	8,287,100	$	0.40
Warrants exercisable at end of period	8,287,100	$	0.40
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, 2010:

	Warrants Outstanding			Warrants Exercisable	
Range of Exercise Price	Number Outstanding at December 31,	Weighted Average Remaining Contractual	Weighted Average Exercise Price	Number Exercisable at December 31, 2010	Weighted Average Exercise Price

		2010	Life				
$	0.20	200,000	0.32 Years	$	0.20	200,000	0.20
$	0.40	7,792,100	0.40 Years	$	0.40	7,792,100	0.40
$	0.50	290,000	2.77 Years	$	0.50	290,000	0.50
$	2.00	5,000	0.55 Years	$	2.00	5,000	2.00
		8,287,100		$	0.40	8,287,100	$0.40

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.

ICEWEB, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2010

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, 2008, 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.

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,	
	2010	**2009**
Expected volatility	129% - 325%	323% - 325%
Expected term	1 - 5 Years	1 - 5 Years
Risk-free interest rate	0.03% - 0.48%	0.03%

Forfeiture Rate	0% - 45%	0% - 45%
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, 2010, total stock-based compensation charged to operations for option-based arrangements amounted to $48,339. At December 31, 2010, there was approximately $126,997 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

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A summary of the status of the Company s outstanding stock options as of December 31, 2010 and changes during the period ending on that date is as follows:

	Number of Options		**Weighted Average Exercise Price**
Stock options			
Balance at beginning of year	11,604,404	$	0.27
Granted			
Exercised	(3,166,667)		0.11
Forfeited	(185,000)		0.23
Balance at end of period	8,252,737	$	0.336
Options exercisable at end of period	6,796,670	$	0.38
Weighted average fair value of options granted during the year		$	

The following table summarizes information about employee stock options outstanding at December 31, 2010:

	Options Outstanding			**Options Exercisable**	
Range of Exercise Price	**Number Outstanding at December 31, 2009**	**Weighted Average Remaining Contractual Life**	**Weighted Average Exercise Price**	**Number Exercisable at December 31, 2009**	**Weighted Average Exercise Price**
$0.001-0.25	4,307,733	2.87 Years	$0.11	2,972,516	$0.11
0.30-0.48	695,000	1.63 Years	0.43	574,150	0.45
0.54-0.60	2,475,004	1.62 Years	0.58	2,475,004	0.58
0.61-0.80	775,000	0.89 Years	0.70	775,000	0.70
	8,252,737		$0.336	6,796,670	$0.38

NOTE 11 - 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, 2010 and 2009 all material assets and revenues of the Company 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, 2010 and 2009 should be read in conjunction with the consolidated financial statements, including footnotes, appearing elsewhere in this quarterly report.

OVERVIEW

Since 2005, the Company has been focused on serving the commercial and federal markets with network security products and proprietary on-line software solutions. In fiscal 2008, the Company acquired INLINE Corporation (now known as IceWEB Storage Corporation), a data storage manufacturing company.

In March, 2009, the Company sold its wholly owned subsidiary, IceWEB Virginia, Inc. to an unrelated 3 rd party, and in the process exited its low-margin IT re-seller business products business to further focus on the higher margin data storage manufacturing business.

At the close of fiscal year 2010, the Company has three key product offerings:

Iplicity Unified Network Storage Solutions

Purpose Built Network/Data Appliances

Cloud Computing Products/Services

In addition, we offer small and medium sized businesses (SMBs) hosted access to enterprise-class applications delivered via the Internet for a reasonable monthly fee. These rapidly growing Cloud Computing offerings include such hosted applications as Microsoft Exchange Server, Sharepoint, BlackBerry Enterprise Server, Good Messaging Server, SPAM and Virus protection, and advanced Email Encryption services. Our current customer base consists of nearly 900 organizations worldwide in both the public and private sectors.

On November 15, 2006, the Company acquired the assets of True North Federal Solutions Group for $350,000 of which $250,000 was paid in cash and $100,000 due upon future terms of the agreement. Under the terms of the agreement, IceWEB acquired the customer database, forecast, contract renewals, and GSA schedule of True North Federal. The revenue generated to IceWEB from this division since the acquisition, exceeded the revenue from the discontinued PatriotNet and IPS operations.

On December 22, 2007, we acquired 100% of the outstanding stock of Inline Corporation for $2,412,731 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 from the date of acquisition. Inline is a leading provider of intelligent enterprise data storage solutions and services for the geospatial intelligence marketplace. 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 $2,688,795, and liabilities of $614,668.

On March 31, 2009, we sold our interest in IceWEB Virginia, Inc. (dba IceWEB Solutions Group, which included the assets acquired from True North Federal Solutions Group) subsidiary to an unrelated third party in exchange for the assumption of approximately $3.2 million in liabilities and 1,000,000 shares of our common stock valued at $80,000. IceWEB Virginia, Inc. was a provider of computer network security products and services such as access control, wide area network optimization, content filtering, email security, intrusion detection, to the Federal, State, and Local government entities. This subsidiary accounted for 43% and 91% of our revenues for fiscal years 2009 and 2008, respectively. We sold this business in order for us to be able to focus on our high margin storage business.

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

Continued focus on the GIS market and expanding our channels of distribution with OEM partners
Continued investment in product development and research efforts
Raising approximately $3 million of additional working capital to expand our marketing, research and development, and restructure our debt.
Hiring additional qualified, technical employees, and
Improving our internal financial reporting systems and processes.

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, 2009 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.

Accounting for Stock Based Compensation - Effective October 1, 2005, we adopted the fair value recognition provisions of ASC Topic 718, Compensation Stock Compensation (Formerly SFAS No. 123 (R), Share-Based Payments using the modified-prospective-transition method. 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 (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.

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, 2010 COMPARED TO THE THREE MONTHS ENDED DECEMBER 31, 2009

The following table provides an overview of certain key factors of our results of operations for the three months ended December 31, 2010 as compared to the three months ended December 31, 2009:

	Three months ended December 31, 2010	Three months ended December 31, 2009	$ of Change
Net Revenues	$ 677,853	$ 600,817	$ 77,036
Cost of sales	350,657	273,624	77,033
Operating Expenses:			
Marketing and selling	455,022	312,857	142,165
Depreciation and amortization	166,617	167,474	(857)
Research and development	206,126	79,565	126,561
General and administrative	657,366	1,093,970	(436,604)
Total operating expenses	1,485,131	1,653,866	(168,735)
Loss from operation	(1,157,935)	(1,326,673)	168,738
Total other income (expense)	(97,880)	(132,961)	35,081
Net loss	$ (1,255,815)	$ (1,459,634)	$ 203,819

Other Key Indicators:

	Three months ended December 31, 2010	Three months ended December 31, 2009	% Change
Cost of sales as a percentage of revenues	51.7%	45.5%	6.2%
Gross profit margin	48.3%	54.5%	(6.2%)
General and administrative expenses as a percentage of revenues	97.0%	182.1%	(85.1%)

Total operating expenses as a percentage of revenues	219.1%	275.3%	(56.2%)

Revenues

For the three months ended December 31, 2010, we reported revenues of $677,853 as compared to revenues of $600,817 for the three months ended December 31, 2009, an increase of $77,036 or approximately 12.8%.

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, 2010, cost of sales was $350,657, or approximately 51.7% of revenues, compared to $$273,624, or approximately 45.5% of revenues, for the three months ended December 31, 2009. The increase in costs of sales as a percentage of revenue and the corresponding decrease in our gross profit margin for the three months ended December 31, 2010 as compared to the three months ended December 31, 2009 was the result of higher costs for certain components of cost of goods. We anticipate that our gross profit margins will continue to be in the 48% to 50% range through the balance of fiscal 2011.

Total Operating Expenses

Our total operating expenses decreased approximately 10.2% to $1,485,131 for the three months ended December 31, 2010 as compared to $1,653,866 for the three months ended December 31, 2009. These changes include:

Marketing and Selling. For the three months ended December 31, 2010, marketing and selling costs were $455,022 as compared to $312,857 for the three months ended December 31, 2009, an increase of $142,165 or approximately 45.4%. The increase was due to an increase in sales and marketing related headcount during the three months ended December 31, 2010 versus the prior year.

Depreciation and amortization expense. For the three months ended December 31, 2010, depreciation and amortization expense amounted to $166,617 as compared to $167,474 for the three months ended December 31, 2009, virtually unchanged from prior year.

Research and Development. For the three months ended December 31, 2010, research and development costs were $206,126 as compared to $79,565 for the three months ended December 31, 2009, an increase of $126,561 or approximately 159.1%. The increase is due to higher Research and development headcount dedicated to our storage products.

General and administrative expense. For the three months ended December 31, 2010, general and administrative expenses were $657,366 as compared to $1,093,970 for the three months ended December 31, 2009, a decrease of $436,604 or approximately 39.9%. For the three months ended December 31, 2010 and 2009 general and administrative expenses consisted of the following:

	Fiscal Q1 2011	**Fiscal Q1 2010**
Occupancy	$ 7,960	$ 6,775
Consulting	55,236	29,773
Employee compensation	336,861	966,620
Professional fees	18,722	32,050
Internet/Phone	4,582	3,217
Travel/Entertainment	7,993	3,154
Investor Relations	63,193	12,094
Licenses	639	
Insurance	11,023	13,216
Other	151,157	27,071
	$ 657,366	$ 1,093,970

For the three months ended December 31, 2010, Occupancy expense increased to $7,960 as compared to $6,775. Occupancy expense is higher due to rent escalations.

For the three months ended December 31, 2010, Consulting expense increased to $55,236 as compared to $29,773.

For the three months ended December 31, 2010, salaries and related expenses decreased to $336,861 as compared to $966,620. Employee compensation is lower due to lower expense related to stock based compensation of $59,000 and the decrease in the amortization of deferred compensation related to employee stock options of $639,935, offset by an increase in salaries of $66,176.

For the three months ended December 31, 2010, Professional fee expense decreased to $18,722 as compared to $32,050. Professional fee expense increased primarily due to legal fees incurred in the normal course of business.

For the three months ended December 31, 2010, travel and entertainment expense increased to $7,993 as compared to $3,154. 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, 2010, Other expense amounted to $151,157 as compared to $27,071 for the three months ended December 31, 2009, an increase of $19,126, or 70.7%. The increase is primarily due to the increase in bad debt expense due to the increase in the allowance for doubtful accounts of $100,000 during the three months ended December 31, 2010.

For the three months ended December 31, 2010 Investor relations expense increased to $63,193 as compared to $12,094 for the three months ended December 31, 2009. 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 2011, 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 $1,157,935 for the three months ended December 31, 2010 as compared to a loss from operations of $1,326,673 for the three months ended December 31, 2009, a decrease of $168,738 or approximately 12.7%.

OTHER INCOME (EXPENSES)

Interest Expense. For the three months ended December 31, 2010, interest expense amounted to $97,880 as compared to $132,961 for the three months ended December 31, 2009, a decrease of $35,081 or 26.4%. The decrease in interest expense is primarily attributable to the decrease in borrowings and certain interest bearing liabilities. Also, during the three months ended December 31, 2010, we amortized deferred financing costs of $6,875, as compared to $6,390 during the three months ended December 31, 2009.

NET LOSS

Our net loss was $1,255,815 for the three months ended December 31, 2010 compared to a loss of $1,459,634 for the three months ended December 31, 2009.

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, 2010 and September 30, 2009:

	December 31, 2010	**September 30, 2010**	**$ Change**	**% Change**
Working Capital	(1,754,917)	(1,250,031)	(504,886)	40.4%
Cash	256,107	540,156	(284,049)	(52.6%)
Accounts receivable, net	1,424,917	1,529,852	(104,935)	(6.9%)
Inventory	107,093	62,197	44,896	72.2%

Total current assets	1,862,208	2,170,310	(308,102)	(14.2%)
Property and equipment, net	328,748	418,873	(90,125)	(21.5%)
Intangibles, net	486,180	546,952	(60,772)	(11.1%)
Marketable Securities	51,840	524,800	(472,960)	(90.1%)
Total assets	2,742,295	3,674,255	(931,960)	(25.4%)
Accounts payable and accrued liabilities	1,846,861	1,711,619	135,242	7.9%
Notes payable-current	1,726,993	1,649,140	77,853	4.7%
Note payable - related party	0	0	0	0.0%
Deferred revenue	43,271	59,582	(16,311)	(27.4%)
Total current liabilities	3,617,125	3,420,341	196,784	5.8%
Total liabilities	3,617,125	3,420,341	196,784	5.8%
Accumulated deficit	(30,878,606)	(29,622,792)	(1,255,814)	4.2%
Stockholders deficit	(874,829)	253,913	(1,128,742)	(444.5%)

Net cash used in operating activities was $697,182 for the three months ended December 31, 2010 as compared to net cash used in operating activities of $848,697 for the three months ended December 31, 2009, a decrease of $151,515. For the three months ended December 31, 2010, we had a net loss of $1,255,815, along with non-cash items such as depreciation and amortization expense of $166,617, share-based compensation expense of $200,692, offset by changes in assets and liabilities of 163,609. During the three months ended December 31, 2010 we experienced a decrease in accounts receivable of $104,935, and an increase in accounts payable and accrued liabilities during the period of $135,242. For the three months ended December 31, 2009, we used cash to fund our net loss of $1,459,634 offset by non-cash items such as depreciation and amortization expense of $167,474, share-based compensation expense of $767,598, and offset by changes in assets and liabilities of $330,526. Also during the three months ended December 31, 2009 we experienced an increase in accounts receivable of $157,389, and a decrease in accounts payable during the period of $68,369.

Net cash used in investing activities for the three months ended December 31, 2010 was $15,720 as compared to net cash used in investing activities of $83,090 for the three months ended December 31, 2009. During the three months ended December 31, 2010, we used cash of $15,720 for property and equipment purchases. During the three months ended December 31, 2009, we used cash of $35,090 for property and equipment purchases, and $48,000 to acquire 800,000 shares of VOIS Inc. common stock.

Net cash provided by financing activities for the three months ended December 31, 2010 was $428,853 as compared to net cash provided of $872,592 for the three months ended December 31, 2009. For the three months ended December 31, 2010, net cash provided by financing activities related to proceeds received from notes payable of $399,012 which were advances under our factoring line with Sand Hill Finance LLC, and proceeds from the exercise of common stock options of $351,000, offset by repayments on notes payable of $321,159 which were to pay down the balance on the Sand Hill Finance LLC factoring line. For the three months ended December 31, 2009, net cash provided by financing activities related to proceeds received from notes payable of $337,209 which were advances under our factoring line with Sand Hill Finance LLC, proceeds from the sale of restricted stock of $190,000, and proceeds from the exercise of common stock options of $650,000, offset by repayments on notes payable of $304,617 which were to pay down the balance on the Sand Hill Finance LLC factoring line.

At December 31, 2010 we had a working capital deficit of $1,754,917 and an accumulated deficit of $30,878,606. The report from our independent registered public accounting firm on our audited financial statements for the fiscal year ended September 30, 2010 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 decreased during the three months ended December 31, 2010 and our sales were not sufficient to pay our operating expenses. We reported a net loss of $1,255,815 for the three months ended December 31, 2010. 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, 2010 we had cash on hand of $256,107. 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, 2010 we owed Sand Hill Finance, LLC $1,726,993 under this accounts receivable line.

We do not have any commitments for capital expenditures. In connection with our annual report for our fiscal year ending September 30, 2010 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. 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, 2010, 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 29, 2010, 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, 2010 we issued 700,000 shares of restricted common stock at a per share price of $0.17, valued at $119,000 to three of our employees. The recipients were accredited investors and the issuances were exempt from registration under the Securities Act of 1933 in reliance on exemptions provided by Section 4(2) of that act.

During October, November, and December, 2010 we issued 265,475 shares of restricted common stock at an average per share price of $0.226, valued at $60,000 to four consultants. The recipients were accredited investors and the issuances were exempt from registration under the Securities Act of 1933 in reliance on exemptions provided by Section 4(2) of that act.

During October, November, and December, 2010 we issued 150,000 shares of restricted common stock to a consultant at an average per share price of $0.23, valued at $34,448. The recipient was an accredited investor and the issuance was exempt from registration under the Securities Act of 1933 in reliance on exemptions 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

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 *
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, 2011

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

February 14, 2011

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