ITRONICS INC
Form 10QSB
August 14, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM l0-QSB

(Mark One)

(X) QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2007

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

For the transition period from______ to_____

Commission File Number 33-18582

ITRONICS INC.

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

TEXAS 75-2198369

(State or other jurisdiction of (IRS Employer Identification Number)

incorporation or organization)

6490 S. McCarran Blvd., Bldg C-23, Reno, Nevada 89509

(Address of principal executive offices)

Issuer's telephone number, including area code: (775)689-7696

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

APPLICABLE ONLY TO CORPORATE ISSUERS

As of July 31, 2007, 402,219,231 shares of common stock were outstanding.

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

ITRONICS INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

JUNE 30, 2007 AND DECEMBER 31, 2006

(UNAUDITED)

ASSETS

	June 30,	December 31,

	2007	2006
CURRENT ASSETS		
Cash	$ 260,282	$ -
Accounts receivable, less allowance for		
doubtful accounts, 2007, $4,600; 2006, $4,600	79,414	36,493
Marketable securities, available for sale	42,969	-
Inventories	804,083	548,399
Prepaid expenses	307,116	316,872
Total Current Assets	1,493,864	901,764
PROPERTY AND EQUIPMENT		
Land	215,000	215,000
Building and improvements	1,312,409	1,167,315
Design and construction in progress,		
manufacturing facility	66,248	234,347
Equipment and furniture	2,877,052	2,543,682
Vehicles	222,298	200,557
Equipment under capital lease-equipment and furniture	466,571	692,438
Equipment under capital lease-vehicles	-	21,741
	5,159,578	5,075,080
Less: Accumulated depreciation and amortization	2,236,163	2,131,542
Total Property and Equipment	2,923,415	2,943,538
OTHER ASSETS		
Intangibles	76,500	76,500

Deferred loan fees, less accumulated amortization 2007,		
$445,302; 2006, $328,120	350,589	335,629
Deposits	8,108	8,108
Total Other Assets	435,197	420,237
	$4,852,476	$4,265,539

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LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

	June 30, 2007	December 31, 2006
CURRENT LIABILITIES		
Bank overdraft	$ -	$ 13,834
Accounts payable	502,765	521,188
Accrued management salaries	667,274	799,948
Accrued expenses	201,318	206,830
Insurance contracts payable	39,713	12,597
Interest payable to officer/stockholders	90,131	87,211
Interest payable, long-term debt and lease obligations	208,365	202,366
Current maturities of long-term debt	46,836	45,065
Current maturities of capital lease obligations	350,850	389,032
Advances from stockholder	161,525	161,525
Current maturities of capital lease due stockholder	-	3,333
Current maturities of convertible notes and accrued interest	3,500,119	3,304,027
Convertible debt derivatives	5,598,128	4,876,175

Warrant and option liability	1,169,824	380,083
Other	113,904	38,166
Total Current Liabilities	12,650,752	11,041,380
LONG-TERM LIABILITIES		
Long-term debt, less current maturities	487,552	504,131
Capital lease obligations, less current maturities	127,845	149,533
Total Long-Term Liabilities	615,397	653,664
Commitments and Contingencies	-	-
Total Liabilities	13,266,149	11,695,044
STOCKHOLDERS' EQUITY (DEFICIT)		
Preferred stock, par value $0.001 per share;		
authorized 999,500 shares; issued and outstanding		
2007, 0 shares; 2006, 0 shares	-	-
Common stock, par value $0.001 per share;		
authorized 1,000,000,000 shares; issued and outstanding,		
381,241,231 at June 30, 2007; 337,581,957 at December 31,		
2006	381,241	337,582
Additional paid-in capital	23,761,099	23,305,788
Accumulated deficit	(33,365,426)	(31,661,456)
Common stock to be issued	799,860	583,868
Accumulated other comprehensive income	3,115	-
Common stock options outstanding, net	6,438	4,713
Total Stockholders Equity (Deficit)	(8,413,673)	(7,429,505)

	$4,852,476	$ 4,265,539

The accompanying notes are an integral part of these financial statements.

ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2007 AND 2006

(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
REVENUES				
GOLD n GRO fertilizer	$847,390	$ 766,563	$1,378,624	$1,098,374
Mining technical services	1,675	1,460	6,628	21,911
Total Revenues	849,065	768,023	1,385,252	1,120,285
COST OF REVENUES (exclusive of depreciation and amortization shown separately below)				
GOLD n GRO fertilizer	722,869	621,356	1,234,740	964,574
Mining technical services	7,667	6,856	15,730	22,665
Total Cost of Revenues	730,536	628,212	1,250,470	987,239
Gross Profit (Loss)(exclusive of depreciation and amortization shown separately below	118,529	139,811	134,782	133,046

OPERATING EXPENSES				
Depreciation and amortization	52,392	57,114	104,621	113,628
Research and development	91,572	68,619	188,854	140,995
Sales and marketing	283,703	175,055	560,914	361,080
Delivery and warehousing	66,220	52,555	91,136	70,112
General and administrative	239,744	236,402	474,396	455,562
Total Operating Expenses	733,631	589,745	1,419,921	1,141,377
Operating (Loss)	(615,102)	(449,934)	(1,285,139)	(1,008,331)
OTHER INCOME (EXPENSE)				
Interest expense	(317,550)	(305,844)	(602,558)	(587,143)
Gain (loss) on derivative instruments	(311,142)	986,137	(168,753)	1,492,406
Gain (loss) on sale of investments	7,718	43,497	352,009	97,728
Other	471	91	471	91
Total Other Income (Expense)	(620,503)	723,881	(418,831)	1,003,082
Income (Loss) before provision for income tax	(1,235,605)	273,947	(1,703,970)	(5,249)
Provision for income tax	-	-	-	-
Net Income(Loss)	(1,235,605)	273,947	(1,703,970)	(5,249)
Other comprehensive income (loss)				
Unrealized gains (losses) on securities	868	(47,783)	3,115	39,889
Comprehensive Income (Loss)	$(1,234,737)	$ 226,164	$(1,700,855)	$ 34,640

Weighted average number of shares				
Outstanding (1,000 s)	374,749	213,590	366,715	206,315
Earnings (Loss) per share, basic				
and diluted	$(0.003)	$0.001	$(0.005)	$ -

See Notes to Condensed Consolidated Financial Statements

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ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND THE YEAR ENDED DECEMBER 31, 2006

(UNAUDITED)

	COMMON STOCK				COMMON	ACCUMULATED
	NUMBER OF		ADDITIONAL		STOCK TO	OTHER
	SHARES		PAID-IN	ACCUMULATED	BE	COMPREHENSIVE
	(1,000 s)	AMOUNT	CAPITAL	DEFICIT	ISSUED	INCOME
Balance, Dec. 31, 2005	197,148	$197,148	$21,646,307	$(27,851,571)	$573,993	$(39,889)
Issue of common stock:						
For cash	100	100	7,400	-	-	-
For services	24,350	24,350	412,703	-	(3,725)	-
For debt conversion	108,723	108,723	1,114,839	-	13,600	-
For asset acquisition	7,261	7,261	124,539	-	-	-
Net (loss) for the year						
ended Dec. 31, 2006	-	-	-	(3,809,885)	-	-

Other comprehensive income for the year ended Dec. 31, 2006	-	-	-	-	-	39,889
Common stock options outstanding	-	-	-	-	-	-
Balance, Dec. 31, 2006	337,582	337,582	23,305,788	(31,661,456)	583,868	-
Issue of common stock						
For services	17,238	17,238	299,021	-	223,817	-
For debt conversion	23,066	23,066	112,909	-	(7,825)	-
For asset acquisition	3,355	3,355	43,381	-	-	-
Net (loss) for the six months ended June 30, 2007	-	-	-	(1,703,970)	-	-
Other comprehensive income for the six months ended June 30, 2007	-	-	-	-	-	3,115
Common stock options outstanding	-	-	-	-	-	-
Balance, June 30, 2007	381,241	$ 381,241	$23,761,099	$(33,365,426)	$ 799,860	$ 3,115

The accompanying notes are an integral part of these financial statements

ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006

(UNAUDITED)

	Six Months Ended June 30,	
	2007	2006
Cash flows from operating activities		
Net loss	$(1,703,970)	$(5,249)
Adjustments to reconcile net loss to cash used by operating activities:		
Depreciation and amortization	221,803	252,324
Interest on convertible notes	332,183	285,791
(Gain) loss on change in fair value of derivative instruments	168,753	(1,492,406)
Gain on sale of investments	(352,009)	(97,728)
Addition of silver in solution inventory by offsetting photochemical processing fees	(171,971)	(16,246)
Stock option compensation	1,725	3,290
Expenses paid with issuance of common stock:		-
Consulting expenses	181,929	18,367
Director fees	10,388	713
Salaries	159,942	15,025
(Increase) decrease in:		
Trade accounts receivable	(42,921)	(140,718)
Inventories	(56,413)	3,999

Prepaid expenses, deposits and other	(75,725)	(12,145)
Increase (decrease) in:		
Accounts payable	(18,426)	96,982
Accrued management salaries	113,326	91,661
Accrued expenses and contracts payable	106,261	(40,578)
Net cash used by operating activities	(1,125,125)	(1,036,918)
Cash flows from investing activities:		
Acquisition of property and equipment	(37,762)	(29,095)
Sale of investments	312,156	229,374
Net cash provided by investing activities	274,394	200,279
Cash flows from financing activities:		
Proceeds from sale of stock	-	7,500
Proceeds from officer/stockholder advances	8,000	10,212
Proceeds from debt	1,290,000	982,500
Debt issuance costs	(87,142)	(118,735)
Account receivable/inventory factoring, net	-	65,000
Payments on debt	(86,011)	(113,968)
Net cash provided by financing activities	1,124,847	832,509
Net increase (decrease) in cash	274,116	(4,130)
Cash, beginning of period	(13,834)	24,260
Cash, end of period	$ 260,282	$ 20,130

The accompanying notes are an integral part of these financial statements.

ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2007 AND 2006

(UNAUDITED)

(continued)

	Six Months Ended June 30,	
	2007	2006
Supplemental Disclosures of Cash Flow		
Information:		
Cash paid during the period for interest	$ 144,274	$ 135,795
Non-cash financing and investing activities:		
Marketable securities received for sale of investment	138,353	-
Common stock issued to settle:		
Convertible notes	128,150	575,822
Accrued management salaries	246,000	-
Acquisition of assets by issuance of common stock:		-
Equipment	46,736	-
Inventory	27,300	-
Warrants issued for debt issuance costs	-	17,594
Amounts withheld from proceeds of debt, unrelated:		
Deferred loan costs	45,000	17,500

The accompanying notes are an integral part of these financial statements.

ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007

(UNAUDITED)

1. The unaudited condensed consolidated financial statements presented herein have been prepared in accordance with the instructions to Form 10-QSB and do not include all of the information and disclosures required by U.S. Generally Accepted Accounting Principles. Therefore, these financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company's Form 10-KSB for the year ended December 31, 2006. These financial statements reflect all adjustments that are, in the opinion of management, necessary to fairly state the results for the interim periods reported. Certain amounts from the prior period have been reclassified to be consistent with the current period presentation.

2. The Company's consolidated financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company and its subsidiaries have reported recurring losses from operations, including a net loss of $1,703,970 during the six months ended June 30, 2007, a working capital deficit of $11,156,888, and a stockholders deficit balance of $8,413,673 as of June 30, 2007. These factors indicate the Company and its subsidiaries' ability to continue in existence is dependent upon their ability to obtain additional long-term debt and/or equity financing and achieve profitable operations. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company and its subsidiaries be unable to continue in existence. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results to be expected for the full year.

3. In January, March, and June 2007 the Company entered into callable secured convertible debt financings (the "Notes") for a total of $1,335,000 from the same investors as previous callable secured debt financings in 2005 and 2006. The Notes have three year terms, interest rates of 6% to 8% per annum, and are accompanied by Registration Rights Agreements. The Company received net proceeds of $1,290,000 from the Notes and issued a total of 50,000,000 seven year warrants at an exercise price of $0.01 per share.

The Notes are convertible into common stock at the lesser of $0.10 or 55% of the market price of the Company s common stock, as defined. Additionally, the Notes are secured by substantially all of the Company s assets and are further secured by 14,550,558 common shares of the Company which are owned by an officer/stockholder.

The Notes have an additional provision that the Company may redeem the debt prior to maturity by paying all outstanding balances plus a 50% prepayment penalty.

The face amount of all the callable secured convertible notes and accrued interest was $4,534,699 and $3,191,759 as of June 30, 2007 and December 31, 2006, respectively.

The Notes are potentially convertible into an unlimited number of shares of common stock. Accordingly, the Company has accounted for the Notes under SFAS 133, EITF 00-19 and DIG s B38 and B39 which require the beneficial conversion

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007

(UNAUDITED)

features and the prepayment penalties of each of the Notes to be treated as embedded derivatives, to be recorded as a collective liability equal to the estimated fair value of the embedded derivatives. The Notes were convertible into 588,921,991 and 586,181,548 common shares at June 30, 2007 and December 31, 2006, respectively, and the conversion and prepayment features had estimated fair values of $5,598,128 and $4,876,175, at June 30, 2007 and December 31, 2006, respectively. The fair value of the conversion features and the prepayment penalties were estimated using the Black-Scholes option pricing model and taking a weighted average value based on certain probabilities that the debt would be converted and paid off prior to maturity at specified dates. The estimated fair value of the conversion features and prepayment penalties exceeded the carrying value of the Notes and the change in this excess amount for each reporting period is recorded as a gain or loss on derivative instruments in the Condensed Consolidated Statements of Operations. As the Company s common stock is highly volatile, material gains or losses for the change in estimated fair value are likely to occur in future periods.

In addition, all non-employee warrants and options that are exercisable during the period in which the Notes are outstanding are required to be recorded as liabilities at their fair value. Non-employee warrants and options to acquire a total of 102,315,001 and 58,599,501 common shares were outstanding at June 30, 2007 and December 31, 2006, respectively, and had estimated fair values of $1,169,824 and $380,083 at June 30, 2007 and December 31, 2006, respectively.

Assumptions used to value these instruments included assuming the Notes would be converted to common stock in equal amounts on a monthly basis, beginning July 2007, until the estimated full conversion of each Note, assuming all warrants and options would be exercised on their respective expiration dates, using volatility rates ranging from 90% and 105% for June 30, 2007 and 87% to 109% for December 31, 2006, and using risk free interest rates ranging from 4.28% to 4.96% for June 30, 2007 and 4.625% to 4.75% for December 31, 2006.

During the period of January 1, 2007 to June 30, 2007, the Noteholders converted a total of $128,150 of the Notes into 21.8 million common shares. Subsequent to June 30, 2007 through August 13, 2007 the Noteholders converted a total of $213,175 of the Notes into 36.75 million common shares.

In connection with the above described Notes, the Company entered into Registration Rights Agreements (the "Agreements") with the Noteholders, whereby the Company has agreed to use its best efforts to file, and have declared effective, registration statements with the Securities and Exchange Commission (SEC) within a specified number of days from the date of the Notes. The Company is required under the Agreements to register a number of shares no less than 2 times the number of shares required to convert all the convertible Notes. Each of the Notes have three year terms and the last Notes were issued on June 27, 2007.

These arrangements are classified as registration payment arrangements under FSP EITF 00-19-2. This new standard became effective for the first quarter of

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007

(UNAUDITED)

2007 and requires the Company to evaluate the probability of incurring penalties related to non-performance of the requirements of the Agreements. The Agreements provide for a penalty of 2% per month of the outstanding principal balance of the Notes if various provisions of the Agreements are not met, which amounted to $83,809 as of June 30, 2007. The penalties accrue for as long as the terms of the Agreements are not met. At the Company s election, the penalties may be settled in either cash or in the Company s common stock priced at the Conversion Price as defined in the Notes. As of June 30, 2007 our evaluation of the Agreements and the penalty provisions determined that the probability of incurring the penalties is remote, and accordingly, no amount for these penalties has been accrued.

4.

As of June 30, 2007 we have accrued for liabilities, including interest, of $539,347 which relate to various lawsuits and claims for the collection of the funds due. These include 8 leases totaling $372,300 (reflected in Capital Lease Obligations) plus $54,835 in additional interest (reflected in Accrued Interest) and one trade payable totaling $85,801 (reflected in Accounts Payable) plus $26,411 in additional interest (reflected in Accrued Interest). The leases are individually secured by specified equipment.

The accrued interest noted above was recorded based on our assessment of three cases that are seeking $251,522, which we believe are probable. The creditors have received judgments in these cases, but have taken no further collection action. The Company will continue to accrue interest until these cases are settled or paid in full.

The Company has a total of two cases, that originally sought $171,853, that we deem to have a remote possibility of incurring an additional unrecorded loss. The Company has negotiated payment agreements on these cases and, as of June 30, 2007, the recorded liability for these cases was $169,070. We are current in our payments under the respective settlement agreements.

In addition to the above leases that are subject to litigation, there are four leases, with a recorded liability of $192,080, that are in default. As required by U.S. Generally Accepted Accounting Principles, the principal balance of the leases that are in default have been classified as current liabilities.

Successful settlement of the above claims is dependent on future financing.

The Company may become involved in a lawsuit or legal proceeding at any time in the ordinary course of business. Litigation is subject to inherent uncertainties, and an unexpected adverse result may arise that may adversely affect its business. Certain lawsuits have been filed against the Company for collection of funds due that are delinquent, as described above. The Company is not aware of any additional legal proceeding or claims that it believes will have, individually or in the aggregate, a material adverse affect on its business, financial condition or operating results.

ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007

(UNAUDITED)

5. In the first quarter of 2006 all of the Series 2000 Convertible Promissory Notes became due and are now in default. The total principal and interest due at June 30, 2007 is $3,500,119. The Company is formulating a plan to seek extensions of these notes and has recorded these notes as current liabilities. No collection action has been taken to date.

6. Following is a summary of finished goods, work in progress, and raw materials inventories as of June 30, 2007 and December 31, 2006. The raw material and work in progress balances below include $557,490 and $405,631 in silver bearing unprocessed photochemicals or partially processed materials as of June 30, 2007 and December 31, 2006, respectively.

	June 30, 2007	Dec. 31, 2006
Finished goods	$ 41,378	$ 19,275
Work in progress	506,052	340,594
Raw materials	360,814	292,691
	908,244	652,560
Less: Silver recoverability		
and slow moving reserves	104,161	104,161
Net Inventory	$804,083	$548,399

7. The Company has outstanding three categories of warrants and options that may be exercised to acquire common stock; these include warrants, convertible debt options, and employee options. The following table summarizes warrant and option activity for the period January 1, 2006 through June 30, 2007:

	Warrants	Convertible Debt Options	Employee Options	Total
Under option, December 31, 2005	27,313,260	134,823,379	6,108,000	168,244,639
Granted	41,496,924	584,810,362	226,000	626,533,286

Exercised	(100,000)	(111,222,642)	-	(111,322,642)
Expired/Adjusted	(10,110,683)	(22,229,551)	(12,000)	(32,352,234)
Under option, December 31, 2006	58,599,501	586,181,548	6,322,000	651,103,049
Granted	50,000,000	24,504,763	135,000	74,639,763
Exercised	-	(21,764,320)	-	(21,764,320)
Expired/Adjusted	(6,284,500)	-	-	(6,284,500)
Under option, June 30, 2007	102,315,001	588,921,991	6,457,000	697,693,992

The average price for all warrants and options granted and exercised was $0.0087 for the six months ended June 30, 2007 and $0.0146 for the year ended December 31, 2006.

The 22,229,551 in expired/adjusted convertible debt options in 2006 listed above is related to the 2000 Series Convertible Promissory Notes discussed in Note 5 above. If the Company is successful in negotiating extensions of these notes, the convertible options may be renewed and the eventual number of potential options could be significantly higher than the amount that was adjusted.

The following table summarizes the warrants and options outstanding as of June 30, 2007:

Expiration Dates	No. of Shares	Exercise Price	Weighted Average Exercise Price
Warrants:			
January to June 2014	50,000,000	$0.010	
November 2013	20,000,000	0.040	

July 2013	20,000,000