

ITRONICS INC
Form 10QSB/A
February 06, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB/A

Amendment No. 2

(Mark One)

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

For the quarterly period ended September 30, 2005

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 October 31, 2005, 197,057,628 shares of common stock were outstanding.

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

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ITRONICS INC. AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

ITRONICS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2005 AND DECEMBER 31, 2004
(UNAUDITED)

ASSETS

| September 30, | December 31, |
|---------------|--------------|
| <u>2005</u> | <u>2004</u> |

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CURRENT ASSETS

| | | |
|--|-----------|----------|
| Cash | \$702,014 | \$ 5,180 |
| Accounts receivable, less allowance for doubtful accounts, 2005, \$5,700; 2004, \$5,700 | 102,187 | 188,805 |
| Marketable securities, available for sale | 109,735 | 26,180 |
| Inventories | 567,834 | 571,704 |
| Prepaid expenses | 168,429 | 142,509 |
| Total Current Assets | 1,650,199 | 934,378 |

PROPERTY AND EQUIPMENT

| | | |
|--|-----------|-----------|
| Land | 215,000 | 215,000 |
| Building and improvements | 1,167,315 | 1,167,315 |
| Design and construction in progress, manufacturing facility | 178,921 | 121,171 |
| Equipment and furniture | 2,087,140 | 2,071,998 |
| Vehicles | 194,733 | 133,028 |
| Equipment under capital lease—equipment and furniture | 1,008,432 | 1,008,432 |
| Equipment under capital lease—vehicles | 21,741 | 87,672 |
| | 4,873,282 | 4,804,616 |
| Less: Accumulated depreciation and amortization | 1,851,671 | 1,670,668 |
| | 3,021,611 | 3,133,948 |

OTHER ASSETS

| | | |
|---|---------|--------|
| Intangibles, net of amortization | 77,051 | 8,435 |
| Deferred loan fees, net of amortization | 318,881 | 48,654 |
| Deposits | 17,212 | 22,525 |

| | | |
|--|-------------|-------------|
| | 413,144 | 79,614 |
| | \$5,084,954 | \$4,147,940 |

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LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

| | September 30, | December 31, |
|--|---------------|--------------|
| | <u>2005</u> | <u>2004</u> |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 429,041 | \$ 558,566 |
| Account receivable and inventory factoring | 94,777 | 51,229 |
| Accrued management salaries | 570,771 | 389,127 |
| Accrued expenses | 191,968 | 398,731 |
| Insurance contracts payable | 27,309 | 15,048 |
| Interest payable to officer/stockholders | 12,917 | 6,307 |
| Interest payable | 252,454 | 204,909 |
| Current maturities of long-term debt | 57,779 | 522,845 |
| Current maturities of capital lease obligations | 665,697 | 807,746 |
| Current maturities of advances from an officer/stockholder | 161,525 | 161,525 |
| Current maturities of capital lease due stockholder | 5,600 | 5,420 |
| Current maturities of convertible notes and accrued interest | 2,839,502 | 1,020,946 |
| Convertible debt derivative | 2,361,505 | - |
| Warrant and option liability | 425,152 | - |
| Other | 31,621 | 21,429 |
| Total Current Liabilities | 8,127,618 | 4,163,828 |

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LONG-TERM LIABILITIES

| | | |
|--|-----------|-----------|
| Long-term debt, less current maturities | 541,045 | 97,022 |
| Convertible promissory notes, less current maturities | - | 1,517,000 |
| Accrued interest, convertible notes, less current maturities | - | 925,216 |
| Capital lease obligation, shareholder, less current maturities | 4,965 | 9,144 |
| Total Long-Term Liabilities | 546,010 | 2,548,382 |
| | 8,673,628 | 6,712,210 |

STOCKHOLDERS' EQUITY (DEFICIT)

| | | |
|--|--------------|--------------|
| Preferred stock, par value \$0.001 per share; authorized 999,500 shares, issued and outstanding 2005, 0 shares; 2004, 0 shares | - | - |
| Common stock, par value \$0.001 per share; authorized 250,000,000 shares, issued and outstanding, 196,907,628 at September 30, 2005; 164,863,938 at December 31, 2004 | 196,908 | 164,864 |
| Additional paid-in capital | 21,633,011 | 19,438,213 |
| Accumulated deficit | (25,976,625) | (22,944,959) |
| Common stock to be issued | 579,530 | 786,426 |
| Accumulated other comprehensive income (loss) | (21,911) | (9,568) |
| Common stock options outstanding, net | 413 | 754 |
| | (3,588,674) | (2,564,270) |
| | \$5,084,954 | \$4,147,940 |

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See Notes to Condensed Consolidated Financial Statements

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ITRONICS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004
(UNAUDITED)

| | Three Months Ended Sept. 30, | | Nine Months Ended Sept. 30, | |
|--|------------------------------|-------------|-----------------------------|-------------|
| | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> |
| REVENUES | | | | |
| Photochemical fertilizer | \$ 231,166 | \$ 251,888 | \$1,015,007 | 1,152,395 |
| Mining technical services | 12,230 | 37,846 | 95,690 | 170,349 |
| Total Revenues | 243,396 | 289,734 | 1,110,697 | 1,322,744 |
| COST OF REVENUES (exclusive of depreciation and amortization shown separately below) | | | | |
| Photochemical fertilizer | 279,011 | 291,322 | 1,084,298 | 1,185,096 |
| Mining technical services | 15,698 | 51,199 | 108,177 | 186,596 |
| Total Cost of Revenues | 294,709 | 342,521 | 1,192,475 | 1,371,692 |
| Gross Profit (Loss) (exclusive of depreciation and amortization shown separately below) | (51,313) | (52,787) | (81,778) | (48,948) |
| OPERATING EXPENSES | | | | |
| Depreciation and amortization | 81,834 | 82,119 | 212,718 | 239,568 |
| Research and development | 64,313 | 45,338 | 197,969 | 94,249 |

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| | | | | |
|---------------------------------------|--------------------|------------------|--------------------|--------------------|
| Sales and marketing | 214,325 | 215,549 | 739,596 | 698,956 |
| Delivery and warehousing | 9,366 | 10,807 | 62,357 | 62,688 |
| General and administrative | 204,381 | 210,405 | 689,950 | 672,605 |
| Total Operating Expenses | 574,219 | 564,218 | 1,902,590 | 1,768,066 |
| Operating (Loss) | (625,532) | (617,005) | (1,984,368) | (1,817,014) |
| OTHER INCOME (EXPENSE) | | | | |
| Interest expense | (215,511) | (191,379) | (581,285) | (602,474) |
| Gain (loss) on derivative instruments | (481,236) | - | (481,236) | - |
| Gain (loss) on sale of investments | - | 38,418 | (10,116) | 136,220 |
| Other | 23,607 | 10 | 25,339 | 23 |
| Total Other Income (Expense) | (673,140) | (152,951) | (1,047,298) | (466,231) |
| Income (Loss) before provision | | | | |
| for income tax | (1,298,672) | (769,956) | (3,031,666) | (2,283,245) |
| Provision for income tax | - | - | - | - |
| Net Income (Loss) | (1,298,672) | (769,956) | (3,031,666) | (2,283,245) |
| Other comprehensive income (loss) | | | | |
| Unrealized gains (losses) on | | | | |
| securities | (2,269) | (53,966) | (12,343) | (343,819) |
| Comprehensive Income (Loss) | \$(1,300,941) | \$(823,922) | \$(3,044,009) | \$(2,627,064) |
| Weighted average number of shares | | | | |
| Outstanding (1,000 s) | 195,625 | 144,755 | 187,671 | 136,715 |

Earnings (Loss) per share, basic

and diluted \$(0.007) \$(0.005) \$(0.016) \$(0.017)

See Notes to Condensed Consolidated Financial Statements

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ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004

(UNAUDITED)

| | Nine Months Ended Sept. 30, | |
|---|-----------------------------|---------------|
| | <u>2005</u> | <u>2004</u> |
| Cash flows from operating activities | | |
| Net income (loss) | \$(3,031,666) | \$(2,283,245) |
| Adjustments to reconcile net loss to | | |
| cash used by operating activities: | | |
| Depreciation and amortization | 212,718 | 239,568 |
| Interest on convertible notes | 286,537 | 383,572 |
| (Gain) loss on derivative instruments | 481,236 | - |
| Marketable securities received for services | (116,193) | (33,318) |
| (Gain) Loss on investments | 10,116 | (136,220) |
| Addition of silver in solution inventory by | | |
| offsetting photochemical processing fees | (28,598) | (82,549) |
| Stock option compensation | 43,379 | 536 |
| (Gains) on debt forgiveness | (24,832) | - |
| Other | 2,200 | - |
| Expenses paid with issuance of common stock | 480,322 | 478,045 |

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| | | |
|---|-------------|-------------|
| (Increase) decrease in: | | |
| Trade accounts receivable | 86,618 | (33,593) |
| Inventories | 32,468 | (14,427) |
| Prepaid expenses and deposits | (25,021) | (3,207) |
| Increase (decrease) in: | | |
| Accounts payable | (117,678) | 52,706 |
| Accrued management salaries | 181,644 | 104,711 |
| Accrued expenses and contracts payable | (184,310) | 174,700 |
| Accrued interest | 67,360 | 35,339 |
| Net cash used by operating activities | (1,643,700) | (1,117,382) |
| Cash flows from investing activities: | | |
| Acquisition of property and equipment | (57,142) | (16,506) |
| Acquisition of intangibles | (195,490) | - |
| Proceeds from sale of investments | 10,177 | 320,390 |
| Proceeds from sale of equipment | 500 | - |
| Net cash provided (used) by investing activities | (241,955) | 303,884 |
| Cash flows from financing activities: | | |
| Proceeds from sale of stock | 570,000 | 881,008 |
| Proceeds from debt, stockholder | 95,000 | - |
| Proceeds from debt, unrelated | 2,031,200 | - |
| Proceeds from receivable/inventory factoring, net | 43,548 | 6,191 |
| Payments on debt | (157,259) | (139,011) |
| Net cash provided by financing activities | 2,582,489 | 748,188 |
| Net increase (decrease) in cash | 696,834 | (65,310) |
| Cash, beginning of period | 5,180 | 34,499 |

| | | |
|---------------------|-----------|------------|
| Cash, end of period | \$702,014 | \$(30,811) |
|---------------------|-----------|------------|

See Notes to Condensed Consolidated Financial Statements

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ITRONICS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2004****(UNAUDITED)****(continued)**

Nine Months Ended Sept. 30,

20052004

Supplemental Disclosures of Cash Flow Information:

| | | |
|---|------------|------------|
| Cash paid during the period for interest | \$ 182,321 | \$ 142,901 |
| Non-cash financing and investing activities: | | |
| Common stock issued to settle: | | |
| Accounts payable | 11,845 | 16,855 |
| Convertible notes and accrued interest | 867,101 | 1,164,126 |
| Debt and accrued interest - officer/stockholder | 90,000 | 145,029 |
| Equipment financed with capital leases | - | 2,236 |
| Common stock issued to acquire: | | |
| GOLD n GRO Guardian product rights | 71,500 | - |
| Equipment | - | 181,804 |
| Warrants issued for debt issuance costs | 12,042 | - |
| Officer/stockholder loan of marketable securities | - | 28,276 |
| Fair value of convertible debt derivative | 2,361,505 | - |
| Fair value of warrant and option liability | 425,152 | - |

Amounts withheld from proceeds of debt, unrelated:

| | | |
|--------------------------------------|---------|---|
| Prepaid interest | 90,000 | - |
| Deferred loan costs | 90,000 | - |
| Key man life insurance | 20,000 | - |
| Short term debt and accrued interest | 143,800 | - |

The accompanying notes are an integral part of these financial statements

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(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, 2004. 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 \$3,031,666 during the nine months ended September 30, 2005, a working capital deficit of \$6,477,419, and a stockholders' deficit balance of \$3,588,674 as of September 30, 2005. 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 nine months ended September 30, 2005 were affected by rainy weather in California and are not necessarily indicative of the results to be expected for the full year.

3. A Private Placement of restricted stock with attached three year warrants was closed in June 2005. Terms of the Placement included an offering price of \$0.05 per share, plus an attached three year warrant for one half the number of shares with an exercise price of \$0.075 for the first year, double that amount for the second year, and triple that amount for the third year. During the six months ended June 30, 2005 \$570,000 was received from this private

placement.

4. In July 2005, the Company arranged callable secured convertible debt financing from four unrelated Investors totaling up to \$3,250,000. The first funding of the loan was for \$1,250,000 and the Company received net proceeds after financing costs and prepaid interest of \$866,200. The second funding, for gross proceeds of \$1,000,000 and net proceeds of \$860,000 was received in August 2005 after filing a registration statement with the U.S. Securities and Exchange Commission, and the third funding, for gross proceeds of \$1,000,000, will be received once the registration statement becomes effective. The loans are for three years and they accrue interest at 8% per annum. The Investors receive five year warrants to acquire 3,000,000 Company common shares at an exercise price of \$0.15 per share. The warrants will be issued proportionally as each of the fundings is completed and, accordingly, warrants to acquire 2,076,923 common shares have been issued as of September 30, 2005. The loans are convertible into common shares at the lesser of \$0.10 or 55% of the average of the lowest 3 intraday trading prices during the 20 trading day period ending one trading day before the conversion date. The loans are secured by a security

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(UNAUDITED)

interest in substantially all of the Company's assets, including the assets of its wholly owned subsidiaries, and intellectual property. The loans are further secured by 14,550,558 Company common shares owned by an officer/stockholder.

The callable secured convertible notes (Notes) discussed above include warrants and a beneficial conversion feature. The Notes are convertible at a discount to the market price of the Company's common stock, with no minimum price, so there are potentially an unlimited number of common shares that could be issued upon conversion of the Notes. Accordingly, the Company has accounted for this financing under SFAS 133 and EITF 00-19 which requires the beneficial conversion feature to be treated as an embedded derivative, recording a liability equal to the estimated fair value of the conversion option. In addition, all non-employee warrants and options that are exercisable during the period that the Notes are outstanding are also required to be recorded at fair value as liabilities. As of September 30, 2005 the Notes were convertible into 60,293,428 common shares and the conversion feature had an estimated fair value of \$2,361,505. As of September 30, 2005, non-employee warrants and options to acquire a total of 49,565,842 common shares were outstanding. The estimated fair value of these warrants and options is \$425,152 as of September 30, 2005. The fair value of the conversion feature and the warrants and options were estimated using the Black-Scholes option pricing model. Assumptions used to value these instruments included assuming the Notes would be converted to common stock in equal amounts on a quarterly basis, beginning March 31, 2006, until the end of the respective three year periods of each Note, assuming all warrants and options would be exercised on their respective expiration dates, using volatility rates ranging from 82% to 102%, and using risk free interest rates ranging from 3.875% to 4.125%. The estimated fair value of the options exceed the carrying value of the Notes; therefore, the excess was recorded as an expense in the Other Income (Expense) section of the Condensed Consolidated Statements of Operations. The fair value of the conversion option, warrants and options will be estimated each reporting period with the change in fair value recorded as gain or loss on derivative instruments. As the Company's common stock is highly volatile, material gains or losses for the change in estimated fair value is likely to occur.

The Registration Rights Agreement (Agreement), part of the callable secured convertible note (Notes) financing described above, requires the Company to use its best efforts to have the registration statement become effective on or before 120 days after the initial signing of the various agreements, which was on July 15, 2005. The 120 days expired on November 12, 2005. At the time the Agreement was signed, the Company did not have enough unissued authorized shares to allow the Investors to convert the Notes into common stock. The Agreement required the Company to use its best efforts to obtain shareholder approval to increase the number of authorized shares by October 31, 2005. The Company has been unable to hold its annual meeting to obtain the necessary shareholder approval. The Agreement provides a penalty of 2% of the outstanding Note balances per month if the registration statement is not effective, or if there are not enough authorized shares available at the time the registration statement becomes effective to allow sale of all the registrable securities by the Note holders. Beginning in November 2005, the

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(UNAUDITED)

Company estimates a monthly penalty of approximately \$45,000 per month. The Securities Purchase Agreement (Purchase Agreement) provides for an additional penalty of 3% of the outstanding Note balances per month in the event the Company does not have authorized and reserved shares totaling at least double the number of shares necessary to convert all of the Notes. The Company believes the Purchase Agreement provided until October 31, 2005 for the Company to obtain shareholder approval to increase the authorized shares, and that this penalty became applicable 30 days thereafter. Beginning in November 2005, we estimate a monthly penalty of approximately \$67,500 per month. These penalties are payable, at the option of the Company, in cash or common stock of the Company. The Company believes it is using its best efforts to obtain effectiveness of the registration statement and in getting shareholder approval to increase the authorized shares; if the Investors agree, the penalties would not be incurred.

On January 26, 2006, the Company received net proceeds of \$455,000 on gross proceeds of \$500,000 as an advance toward the final \$1,000,000 proceeds to be received once approval of the registration statement is received. Five year warrants to acquire 461,539 common shares at \$0.15 per share were issued to the Investors in accordance with the terms of the various financing agreements.

5. During the second quarter of 2005, the Company renegotiated its account receivable factoring arrangement. The Company now factors specified raw material inventory items, the related finished GOLD n GRO fertilizer products, and the related accounts receivable from the sale of the specified GOLD n GRO fertilizers. The Company also factored the sale of two Photochemical Concentrators during the quarter. The balance due under these arrangements was \$94,777 at September 30, 2005. These loans were secured by a security interest in the related inventory and account receivable items. Both factoring arrangements were paid in full subsequent to September 30, 2005.

6.

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 our business. Certain lawsuits have been filed against us for collection of funds due that are delinquent, as described below. The Company is

currently not aware of any litigation pending or threatened for any reason other than collection of funds due and already recorded. The Company is not aware of any additional legal proceeding or claims that the Company believes will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

As of September 30, 2005 total recorded liabilities of \$731,081 including accrued interest to September 30, 2005, were subject to a total of 11 separate lawsuits for the collection of the funds due. These include 8 leases totaling \$531,302 (reflected in Current Maturities of Capital Lease Obligations) plus \$65,900 in additional interest (reflected in Accrued Interest) and three trade payables totaling \$121,263 (reflected in Accounts Payable) plus \$12,616 in

ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(UNAUDITED)

additional interest (reflected in Accrued Interest). The leases are individually secured by specified equipment.

The accrued interest noted above was recorded based on the Company's assessment of additional amounts the Company believes is probable and is related to four cases originally seeking \$423,375; the creditors have received judgments in three of these cases and the fourth is in litigation. The Company will continue to accrue interest until these cases are settled or paid in full.

The Company estimates an additional \$10,000 interest may be reasonably possible on one case; however, the Company has not accrued this amount because it does not believe it is probable to be incurred. This estimate is related to one case, seeking \$35,210, that was filed in March 2003, and no further contact has taken place since then.

The Company has six other cases that it deems to have a remote possibility of incurring an additional unrecorded loss. These cases, originally seeking \$313,305, now have a recorded liability of \$204,613. All six cases are under negotiated payment agreements and the payments are current.

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

7. In addition to the above leases that are subject to litigation, there are four leases, with a recorded liability of \$188,255, that are in default. No payments have been made for an extended period of time, and no collection action or recent contact from the creditors has occurred. 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.

In 2003 an offer was made to extend the Series 2000 Convertible Promissory Notes. The holders of \$80,000 of the Notes have not responded to the offer and that amount, plus \$59,351 in accrued interest, remains in default.

8. During the nine months ended September 30, 2005 convertible promissory notes totaling \$616,100 principal and \$251,001 in accrued interest were converted into common stock at \$0.10 per share.

9. Following is a summary of finished goods, work in progress, and raw materials inventories as of September 30, 2005 and December 31, 2004. The raw material balances below include \$382,289 and \$396,614 in unprocessed silver bearing photochemicals as of September 30, 2005 and December 31, 2004, respectively.

ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(UNAUDITED)

| | <u>Sept 30.</u> | <u>Dec. 31.</u> |
|------------------|-----------------|-----------------|
| | <u>2005</u> | <u>2004</u> |
| Finished goods | \$23,841 | \$ 63,615 |
| Work in progress | - | - |
| Raw materials | 543,993 | 508,089 |
| | \$567,834 | \$571,704 |

10. Warrants, options, and shares to be issued, totaling 62,883,997 and 63,860,067 shares as of September 30, 2005 and 2004, respectively, would dilute future Earnings Per Share (EPS). In addition, approximately 8,265,000 shares could be issued upon conversion of callable secured convertible notes as discussed in Note 4. No diluted EPS is presented as the effect of including these shares is antidilutive.

11. Following is financial information for each of the Company's segments. No changes have occurred in the basis of segmentation since December 31, 2004.

Reconciliation of segment revenues, gross profit (loss), operating income (loss), other income (expense), and net income (loss) before taxes to the respective consolidated amounts follows:

ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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SEPTEMBER 30, 2005

(UNAUDITED)

| | Three Months Ended Sept. 30, | | Nine Months Ended Sept. 30, | |
|---|------------------------------|-------------|-----------------------------|---------------|
| | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> |
| Revenues: | | | | |
| Photochemical Fertilizer | \$231,166 | \$251,888 | \$1,015,007 | \$1,152,395 |
| Mining Technical Services | 12,230 | \$37,846 | 95,690 | 170,349 |
| Consolidated Revenues | \$243,396 | \$289,734 | \$1,110,697 | \$1,322,744 |
| Gross Profit (Loss): | | | | |
| Photochemical Fertilizer | \$(47,845) | \$(39,434) | \$(69,291) | \$(32,701) |
| Mining Technical Services | (3,468) | (13,353) | (12,487) | (16,247) |
| Consolidated Gross Profit (Loss) | \$(51,313) | \$(52,787) | \$(81,778) | \$(48,948) |
| Operating Income (Loss): | | | | |
| Photochemical Fertilizer | \$(514,097) | \$(498,312) | \$(1,611,904) | \$(1,490,401) |
| Mining Technical Services | (111,435) | (118,693) | (372,464) | (326,613) |
| Consolidated Operating Income (Loss) | \$(625,532) | \$(617,005) | \$(1,984,368) | \$(1,817,014) |
| Other Income (Expense): | | | | |
| Photochemical Fertilizer | \$(671,911) | \$(191,379) | \$(1,037,685) | \$(602,474) |

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| | | | | |
|---------------------------------|---------------|-------------|---------------|---------------|
| Mining Technical Services | (1,229) | 38,428 | (9,613) | 136,243 |
| Consolidated Other Income | | | | |
| (Expense) | \$(673,140) | \$(152,951) | \$(1,047,298) | \$(466,231) |
| Net Income (Loss) before taxes: | | | | |
| Photochemical Fertilizer | \$(1,186,008) | \$(689,691) | \$(2,649,589) | \$(2,092,875) |
| Mining Technical Services | (112,664) | (80,265) | (382,077) | (190,370) |
| Consolidated Net Income | | | | |
| (Loss) before taxes | \$(1,298,672) | \$(769,956) | \$(3,031,666) | \$(2,283,245) |

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(UNAUDITED)

Identifiable assets by business segment for the major asset classifications and reconciliation to total consolidated assets are as follows:

| | Sept. 30, | December 31, |
|---------------------------|-------------|--------------|
| | <u>2005</u> | <u>2004</u> |
| Current Assets: | | |
| Photochemical Fertilizer | \$1,400,925 | \$ 670,602 |
| Mining Technical Services | 127,303 | 157,603 |
| | 1,528,228 | 828,205 |

Property and Equipment, net:

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| | | |
|---------------------------------|--------------|--------------|
| Photochemical Fertilizer | 2,921,758 | 3,010,749 |
| Mining Technical Services | 99,644 | 122,342 |
| | 3,021,402 | 3,133,091 |
| Other Assets, net: | | |
| Photochemical Fertilizer | 124,404 | 66,849 |
| Mining Technical Services | 559,183 | 1,246,824 |
| | 683,587 | 1,313,673 |
| Total Assets: | | |
| Photochemical Fertilizer | 4,447,087 | 3,748,200 |
| Mining Technical Services | 786,130 | 1,526,769 |
| Total Segment Assets | 5,233,217 | 5,274,969 |
| Itronics Inc. assets | 25,378,053 | 22,504,867 |
| Less: inter-company elimination | (25,526,316) | (23,631,896) |
| Consolidated Assets | \$5,084,954 | \$ 4,147,940 |

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(UNAUDITED)

12. The Company holds marketable securities that are available for sale, which consist solely of equity securities. The carrying amount on the balance sheets of these securities is adjusted to fair value at each balance sheet date. The adjustment to fair value is an unrealized holding gain or loss that is reported in Other Comprehensive Income. At present, these unrealized gains or losses are the only component of Accumulated and Other Comprehensive Income.

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The Company had Accumulated Unrealized Holding Losses of \$21,911 at September 30, 2005 and \$9,568 at December 31, 2004. No gains were reclassified out of accumulated other comprehensive income into earnings during 2005 and no losses were reclassified out of accumulated other comprehensive income into earnings during 2004. The table below illustrates the amount of unrealized holding gains and losses included in other comprehensive income, net of tax effects of \$0. The reclassification adjustment listed in the below table represents unrealized holding gains and losses transferred into earnings as securities are sold.

Following are the components of Other Comprehensive Income:

| | <u>Three Months Ended Sept. 30,</u> | | <u>Nine Months Ended Sept. 30,</u> | |
|--------------------------------------|-------------------------------------|-------------|------------------------------------|--------------|
| | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> |
| Unrealized holding gains (losses) | \$ (2,269) | \$ (2,636) | \$ (20,312) | \$ (27,796) |
| arising during the period | | | | |
| Reclassification adjustment | - | (51,330) | 7,969 | (316,023) |
| Other Comprehensive Income (Loss) | \$ (2,269) | \$ (53,966) | \$ (12,343) | \$ (343,819) |

Following is a summary of gross proceeds and gains and losses from sales of available for sale marketable securities :

| | <u>Three Months Ended Sept.</u> <u>30,</u> | | <u>Nine Months Ended Sept. 30,</u> | |
|---|---|-------------|------------------------------------|-------------|
| | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> |
| Gross proceeds from sale of securities | \$ - | \$ 97,251 | \$ 10,177 | \$ 320,390 |
| Gross gains from sale of securities | \$ - | \$ 41,597 | \$ - | \$ 139,399 |
| Gross losses from sale of securities | - | (3,179) | (10,116) | (3,179) |
| Net Gains (Losses) from sale of Securities | \$ - | \$ 38,418 | \$ (10,116) | \$ 136,220 |

13. The Company applies APB Opinion 25 in accounting for stock options. The following table shows a comparison of option compensation expense between this method compared to the Fair Market Value method under FASB Statement No. 123. The table also indicates the impact on net loss and loss per share:

ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(UNAUDITED)

| | Three Months Ended Sept. 30, | | Nine Months Ended Sept. 30, | |
|-----------------------------------|------------------------------|-------------|-----------------------------|---------------|
| | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> |
| Option Compensation Expense: | | | | |
| As reported | \$ 6,267 | \$ 413 | \$43,379 | \$ 536 |
| Adjustment for additional expense | | | | |
| for fair value of options | 1,588 | 20,214 | 5,343 | 59,632 |
| Pro forma | \$ 7,855 | \$ 20,627 | \$48,722 | \$ 60,168 |
| Net Income (Loss): | | | | |
| As reported | \$(1,298,672) | \$(769,956) | \$(3,031,666) | \$(2,283,245) |
| Adjustment for additional expense | | | | |
| for fair value of options | (1,588) | (20,214) | (5,343) | (59,632) |
| Pro forma | \$(1,300,260) | \$(790,170) | \$(3,037,009) | \$(2,342,877) |
| Earnings (Loss) per share, | | | | |
| basic and diluted | | | | |
| As reported | \$(0.007) | \$(0.005) | \$(0.016) | \$(0.017) |
| Pro forma | \$(0.007) | \$(0.006) | \$(0.016) | \$(0.017) |

Item 2. Management's Discussion and Analysis or Plan of Operations

Some of the information in this report contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as "may," "will," "expect," "anticipate," "believe," "estimate" and "continue," or similar words. You should read statements that contain these words carefully because they:

- discuss our future expectations;
- contain projections of our future results of operations or of our financial condition; and
- state other "forward-looking" information.

We believe it is important to communicate our expectations. However, there may be events in the future that we are not able to accurately predict or over which we have no control. Our actual results and the timing of certain events could differ materially from those anticipated in these forward-looking statements.

Results of Operations

We reported consolidated revenues of \$243,396 for the quarter ended September 30, 2005, compared to \$289,734 for the prior year quarter, a decrease of 16%. The decrease was due to a decrease in Photochemical Fertilizer segment revenue of \$20,700, or 8% and to a decrease of \$25,600 in Mining Technical Services segment revenues, a decrease of 68%. The consolidated net

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loss was \$1,298,672, or \$0.007 per share, for the quarter ended September 30, 2005, compared to a net loss of \$769,956 or \$0.005 per share for the comparable 2004 period, an increased loss of \$528,700, or 69%. Consolidated revenues for the first nine months of 2005 were \$1,110,697 compared to \$1,322,744 for the prior year period, a decrease of 16%. The consolidated net loss was \$3,031,666 or \$0.016 per share, for the nine months ended September 30, 2005, compared to a net loss of \$2,283,245 or \$0.017 per share for the comparable 2004 period, an increased loss of 33%.

To provide a more complete understanding of the factors contributing to the changes in revenues, operating expenses, other income (expense) and the resultant operating income (loss) and net income (loss) before taxes, the discussion presented below is separated into our two operating segments.

PHOTOCHEMICAL FERTILIZER

| | Three Months Ended Sept 30, | | Nine Months Ended Sept 30, | |
|-------------------------|-----------------------------|-------------|----------------------------|-------------|
| | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> |
| Revenues | | | | |
| Fertilizer | \$ 107,378 | \$ 152,230 | \$ 803,276 | \$ 858,619 |
| Photochemical recycling | \$ 59,699 | \$ 82,373 | \$ 101,768 | \$ 212,016 |

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| | | | | |
|--------------------------------|---------------|-------------|---------------|---------------|
| Silver | \$ 64,089 | \$ 17,285 | \$ 109,963 | \$ 81,760 |
| Total Revenue | \$ 231,166 | \$ 251,888 | \$ 1,015,007 | \$ 1,152,395 |
| Gross profit (loss) | \$ (47,845) | \$ (39,434) | \$ (69,291) | \$ (32,701) |
| Operating income (loss) | \$ (514,097) | \$(498,312) | \$(1,611,904) | \$1,490,401) |
| Other income (loss) | \$ (671,911) | \$(191,379) | \$(1,037,685) | \$ (602,474) |
| Net income (loss) before taxes | \$(1,186,008) | \$(689,691) | \$(2,649,589) | \$(2,092,875) |

Total segment revenues for the third quarter of 2005 were approximately \$231,200, a decrease of 8% from the prior year third quarter. Total fertilizer sales for the quarter were \$107,400 (187 tons), compared to \$152,200 (235 tons) for the 2004 third quarter, a decrease of 29% in dollars and a decrease of 20% in tonnage. Sales of bulk Chelated Liquid Micro-nutrients were \$68,400 (94 tons) and \$141,200 (220 tons) for the third quarter of 2005 and 2004, respectively, a decrease of 52% in dollars and a decrease of 57% in tonnage. Sales of bulk Chelated Liquid Multi-nutrients were \$31,300 (93 tons) and \$6,600 (15 tons) for the third quarter of 2005 and 2004, respectively, an increase of 376% in dollars and 520% in tonnage. The overall decrease is attributable to the late spring season in the Central Valley of California, resulting in a late start to the fall season. We had a strong fourth quarter, with fourth quarter 2005 fertilizer sales exceeding the fourth quarter of 2004 by approximately 44%. Also, year to date fertilizer sales slightly exceeded the prior year sales. Total photochemical recycling revenue for the quarter decreased 28% compared to the third quarter of 2004. The recycling services portion of this revenue decreased 79% on decreased volume of 81%. The decrease is due to the December 2004 mutual termination of recycling services for Shutterfly, Inc., a significant photochemical recycling customer. This decrease was partially offset by \$42,000 in sales of two photochemical Silver Concentrators. We are continuing to concentrate our efforts on sales of Photochemical Silver Concentrators. Silver sales increased \$46,800, or 271%, from the third quarter of 2004. Sales of all silver or silver bearing products were \$63,000 (9,007 ounces) for the quarter, compared to \$6,700 (999 ounces) for the 2004 third quarter. This is an increase of 835% in dollars and 802% in ounces. The increase is primarily from increased sales of processed silver bullion due to a combination of increased sales of Chelated Liquid Multi-nutrient liquid fertilizers, which use a high percentage of photochemical base liquid compared to our other

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liquid fertilizers, and to progress in making adjustments to our refining process needed to accommodate changing conditions in the recycling process. Cost of sales decreased \$12,300 due to a decrease of \$16,100 in payroll and related costs. The segment recorded a gross loss of \$47,800 for the quarter, compared to a gross loss of \$39,400 for the third quarter of 2004, an increased gross loss of \$8,400, or 21%.

As mentioned above, we have had a significant decrease in used photochemical volume due to the termination of the Shutterfly contract. We are continuing our efforts on sales of Photochemical Silver Concentrators in order to replace the revenue and to provide a long term base of used photochemical supply. In 2006 we are anticipating the possibility of rapidly expanding spring sales of bulk Chelated Liquid Multi-Nutrient fertilizers which use a high proportion of used photochemicals as a raw material. Because of this possibility, we plan to aggressively seek new large scale photochemical recycling customers beginning in early 2006.

Segment operating expenses increased \$7,400 from the third quarter of 2004. This resulted from a modest increase in sales and marketing expenses.

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These factors resulted in a 2005 third quarter segment operating loss of \$514,100 compared to a loss of \$498,300 for the third quarter of 2004, an increased operating loss of \$15,800, or 3%.

Other expenses were \$671,900 for the quarter, compared to \$191,400 for the 2004 third quarter, an increased expense of \$480,500. The increased expense is due to a loss on derivative instruments of \$481,200 related to the third quarter borrowing of \$2,250,000 in callable secured convertible notes.

The changes in operating loss and other expenses resulted in a segment net loss before taxes of \$1,186,000 for the quarter ended September 30, 2005, compared to a loss of \$689,700 for the prior year quarter, an increased loss of \$496,300 or 72%.

For the first nine months of 2005, segment revenues were \$1,015,000, compared to \$1,152,400 for the comparable 2004 period, a decrease of 12%. The decline is due primarily to the prior year mutual termination of a significant photochemical recycling customer. Gross loss for the first nine months of 2005 was \$69,300, compared to a gross loss of \$32,700 for the comparable prior year period, an increased loss of \$36,600. Operating loss for the first nine months of 2005 was approximately \$1,611,900 compared to \$1,490,400 for the first nine months of 2004, an increased loss of \$121,500, or 8%.

Other expense increased \$435,200 due to a loss on derivative instruments of \$481,200 related to the third quarter borrowing of \$2,250,000 in callable secured convertible notes.

The changes in operating loss and other expenses resulted in a segment net loss before taxes of \$2,649,600 for the nine months ended September 30, 2005, compared to a loss of \$2,092,900 for the prior year period, an increased loss of \$556,700 or 27%.

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MINING TECHNICAL SERVICES

| | Three Months Ended Sept 30, | | Nine Months Ended Sept 30, | |
|-----------------------------------|--------------------------------|-------------|----------------------------|-------------|
| | <u>2005</u> | <u>2004</u> | <u>2005</u> | <u>2004</u> |
| Revenues | \$ 12,230 | \$ 37,846 | \$ 95,690 | \$ 170,349 |
| Gross profit (loss) | \$ (3,468) | \$ (13,353) | \$ (12,487) | \$ (16,247) |
| Operating income (loss) | \$(111,435) | \$(118,693) | \$(372,464) | \$(326,613) |
| Other income (expense) | \$ (1,229) | \$ 38,428 | \$ (9,613) | \$ 136,243 |
| Net income (loss) before taxes | \$(112,664) | \$ (80,265) | \$(382,077) | \$(190,370) |

Mining technical services revenue was \$12,200 for the quarter ended September 30, 2005, compared to \$37,800 for the comparable quarter of 2004, a decrease of 68%. The decrease is due to the expiration of the Golden Phoenix Minerals, Inc. consulting contract in March 2005. Cost of sales decreased by \$35,500, due primarily to decreases of \$24,900 in pass through costs and \$7,700 in labor and consulting costs, as we reallocate our resources to research and development. These factors resulted in a third quarter gross loss for the segment of \$3,500 compared to a gross loss of

\$13,400 for the prior year third quarter, a decreased gross loss of \$9,900.

In early May 2005 the technical services satellite office was closed due to the winding down of most of the technical service contracts and completion of the majority of the data gathering for the insidemetals.com project, but certain key staff members have been retained. Programming is continuing for insidemetals.com and launch of the website Information Portal occurred in August 2005. Revenues from the website have been nominal to date.

The redirection of Whitney & Whitney, Inc. to reduce emphasis on technical consulting services and to launch an internet information portal is brought about by the fact that Dr. Whitney, our President, has often been the lead person in generating new consulting contracts. Our President's increased responsibilities for managing the expanding photochemical recycling segment and overall corporate activities has reduced his time availability to actively participate in the consulting segment. Part of our objective in shifting the focus of the technical services segment is to retain our core professional staff that can provide assistance on possible future technical service contracts as well as perform administrative duties for the photochemical recycling segment, while at the same time adding a potential source of revenue that is not dependent upon labor sales and which can be managed by a professional staff. The information portal also better utilizes the Whitney & Whitney, Inc. library and information resources that are already in existence. For the three and nine months ended September 30, 2005 we allocated costs of approximately \$45,500 and \$144,400, respectively, to the development of the web site. The site was launched in mid-August 2005 and we are now fine-tuning the general presentation of the site, as well as improving the profiled mining company information. We expect this level of spending to continue well into the fourth quarter of 2005. As improvements to the site are completed and information maintenance becomes routine, we will reduce or redirect staff resources as needed.

Total segment operating expenses for the third quarter of 2005 increased nominally, but research and development costs increased \$26,100 due to costs related to developing the insidemetals.com project, which was partially offset by decreases in various other operating expenses.

The combination of these factors resulted in a 2005 third quarter segment operating loss of \$111,400, compared to a loss of \$118,700 for the third quarter of 2004, a decreased operating loss of \$7,300, or 6%.

Other income (loss) for the third quarter of 2005 was a loss of \$1,200 compared to a gain of \$38,400 for the prior year third quarter. This decrease is due to reduced sales of common shares of Golden Phoenix Minerals, Inc. and other marketable securities.

The changes in operating loss and other income resulted in a segment net loss before taxes of \$112,700 for the quarter ended September 30, 2005, compared to a loss of \$80,300 for the prior year quarter, an increased loss of \$32,400, or 40%.

For the first nine months of 2005, segment revenue totaled \$95,700 compared to \$170,300 for the first nine months of 2004, a decrease of 44%. Gross loss for the first nine months of 2005 was \$12,500, compared to a gross loss of \$16,200 for the comparable prior year period, a decreased gross loss of \$3,800. Operating loss for the period was \$372,500 compared to an operating loss of \$326,600 for the comparable 2004 period, an increased operating loss of \$45,900, or 14%. The primary factor contributing to the decline was research and development costs related to the insidemetals.com project.

Other income (loss) for the first nine months of 2005 was a loss of \$9,600 compared to a gain of \$136,200 for the prior year period. This decrease is due to reduced sales of common shares of Golden Phoenix Minerals, Inc. and other marketable securities.

The changes in operating loss and other income resulted in a segment net loss before taxes of \$382,100 for the nine months ended September 30, 2005, compared to a net loss of \$190,400 for the prior year period, an increased loss of \$191,700.

SUMMARY

On a consolidated basis, the various changes in revenues and operating expenses resulted in a third quarter 2005 operating loss of \$625,500, compared to \$617,000 for the third quarter of 2004, an increased operating loss of \$8,500, or 1%. Net loss before taxes for the third quarter 2005 was \$1,298,700 compared to \$770,000 for the prior year third quarter, an increased loss of \$528,700 or 69%. For the nine month period ended September 30, 2005 the operating loss was \$1,984,400 compared to \$1,817,000 for the prior year comparable period, an increased operating loss of \$167,400, or 9%. Net loss before taxes for the nine months ended September 30, 2005 was \$3,031,700 compared to \$2,283,200 for the prior year nine month period, an increased loss of \$748,400, or 33%.

Changes in Financial Condition; Capitalization

Cash amounted to \$702,000 as of September 30, 2005, compared to \$(30,800) as of September 30, 2004. Net cash used for operating activities was approximately \$1,643,700 for the first nine months of 2005. The cash used for operating activities during the period was financed by a combination of sales of common stock of \$570,000 from a private placement of restricted common stock and attached warrants, short term loans from an officer/stockholder of \$95,000, short term financing of \$125,000, net proceeds of \$1,906,200 from the issuance in callable secured

convertible notes and \$43,500 in inventory and account receivable factoring.

Total assets increased \$937,000 during the nine months ended September 30, 2005 to \$5,085,000. Current assets increased \$715,800 due to increases in cash of \$696,800 and marketable securities of \$83,600 due to receipt of the final billings for services to GPXM in their restricted common stock. At September 30, 2005 we owned 567,100 shares of GPXM with a current market value of \$109,700. These increases in current assets were partially offset by a decrease in accounts receivable of \$86,600, which is primarily attributable to receipt of final payment of amounts due from GPXM. Net property and equipment decreased \$112,300 due to depreciation and amortization. Other assets increased \$333,500 due to the acquisition of the product rights of the GOLD n GRO Guardian fertilizer for \$71,500 in restricted common stock and to an increase in deferred loan fees of \$270,200 related to the callable secured convertible note financing.

Current liabilities increased during the nine months ended September 30, 2005 by \$3,963,800 and total liabilities increased by \$1,961,400. Total liabilities increased due to the \$2,250,000 callable secured convertible debt financing. Due to the structure of this financing, it was accounted for under derivative accounting rules, resulting in recording the conversion feature of the debt and all outstanding non-employee warrants and options at a combined fair value of \$2,786,700, which was partially offset by the conversion into common stock of a total of \$867,100 in Convertible Promissory Notes and accrued interest. Changes in current liabilities include increases of \$2,786,700 in derivative instrument liabilities as discussed above, \$43,500 in account receivable and inventory factoring, \$181,600 in accrued management salaries, \$47,500 in accrued interest, and \$1,818,600 in current maturities of convertible notes and accrued interest. The increase in current maturities of convertible notes is due to the reclassification from long term debt of the 2000 Series Convertible Promissory Notes that were extended to 2006 and are now due within one year of the balance sheet date. These increases were partially offset by decreases of \$129,500 in accounts payable, \$206,800 in accrued expenses, which reflects payment of all past due federal payroll tax obligations, \$465,100 in current maturities of long term debt, which reflects the reclassification of the mortgage obligation on the Stead manufacturing facility to long term debt, and \$142,000 in current maturities of capital lease obligations.

Addressing our financial condition, improvements have been made. The stockholders' deficit, \$4,587,900 at December 31, 2002, has been reduced to a deficit of \$3,588,700 at September 30, 2005, an improvement of \$999,200. This has been achieved by the conversion of approximately \$4.3 million in convertible notes and accrued interest into common stock. One significant area of difficulty for us has been meeting the payments on capital lease obligations. However, the capital lease obligation at December 31, 2002 of \$1,193,900 has been reduced to \$665,700 at September 30, 2005, a reduction of \$528,200. This includes the write off of five leases as debt forgiveness income in 2004 of \$187,800.

Liquidity and Capital Resources

During the nine months ended September 30, 2005, working capital decreased by \$3,248,000 to a deficit balance of \$6,477,400. The decrease is due to a combination of the \$2,786,700 in derivative instruments discussed above and the reclassification from long term debt of a net \$1,818,600 in convertible notes and accrued interest, which was partially offset by the various

factors in current assets and liabilities discussed above in Changes in Financial Condition; Capitalization.

To meet short term cash needs, we factor certain inventory items and receivables. This process enables us to keep limited raw materials on hand for immediate production and to obtain cash immediately upon selling product. We generally receive payment from our customers within 30 days of sales; we then repay the factoring loan. The arrangement is with unrelated individuals, carries interest at 2% to 3% per month, and is generally limited to \$120,000 at any one time. The lenders are secured by a blanket UCC on specified inventory items, which is on file with the State of Nevada. A UCC form is also filed for individual invoices to further secure the lender. Our present factoring balances were paid off in November 2005 and the arrangements have been discontinued. As a replacement, we have negotiated a 10 day payment period on invoices to our primary distributor, at a cost of 1% of the invoice amount. As working capital needs increase to fund sales growth, especially during peak seasons, we may need to seek new factoring arrangements.

A private placement of stock with attached warrants was closed in June 2005, with \$570,000 received during the six months ended June 30, 2005. In July 2005 we obtained 8% convertible debt financing for up to \$3.25 million, with the final amount dependent upon the filing and effectiveness of a registration statement relating to common shares underlying the convertible debt and warrants issued in the recent financing. As of September 30, 2005, we had completed the first two of three closings and received net proceeds after financing expenses and prepaid interest of \$1,726,200. In January 2006 we received net proceeds of \$455,000 on gross proceeds of \$500,000 as an advance on the final \$1,000,000 of the financing. The funding will provide for working capital, manufacturing plant expansion, registration of GOLD n GRO Guardian fertilizer with the EPA, and debt reduction. It is anticipated that this funding, subject to receiving shareholder approval to increase our authorized shares and having our registration statement declared effective, will provide for our capital needs through March to June 2006, depending on fertilizer sales growth.

There has been a long term commitment by officers and other members of management to support the Company by investing funds for our growth. One officer/shareholder has invested a total of \$1,423,400 in cash and deferred salary during the period 2001 through September 30, 2005. Two other members of management have deferred salary totaling \$567,900 during the same period. Additional members of management invested \$62,000 cash in 2003. All such cash and deferred salary that have been invested in our private placements were under the same terms and conditions as all other investors.

The actual rate of growth in fertilizer and the related photochemical and silver sales necessary to achieve profitability is subject to a number of uncertainties, including the annual seasonal nature of fertilizer sales related to crop cycles, short term weather patterns in specific markets, the rate of GOLD n GRO fertilizer adoption in existing and new markets, and the availability of funding to support sales growth.

Growth Plans and Implementation

Our Photochemical Fertilizer Division created the GOLD 'n GRO line of liquid fertilizers. The pioneering development work is complete, field trials have been completed on the first products and other field trials are under way.

The Mining Technical Services Division originally provided typical consulting services which required high level technical personnel, including our President, devoted to each project. To reduce our dependence on our President to generate new consulting contracts, while better utilizing our core professional staff, the division is being reconfigured to focus most of its efforts on a global Internet Information Portal "insidemetals.com". The information portal operates 24 hours per day 7 days per week anywhere in the world where computers and the Internet are available. Anyone with access to the Internet anywhere in the world can subscribe to the service at any time using their credit card to pay the subscription fee.

With the successful completion of the initial pioneering development work by the Photochemical Fertilizer Division, and with the launch of the information portal by the Mining Technical Services Division, we are implementing growth plans for both divisions that are expected to drive expansion well into the future. The status of these plans and their implementation is described for each division.

Photochemical Fertilizer Division (Itronics Metallurgical, Inc.)

Our manufacturing plant is presently configured to produce 1.2 million gallons (on a single shift basis) of GOLD 'n GRO fertilizer annually (about 5,700 tons) and can be expanded to produce 7.2 million gallons of GOLD'n GRO per year, or about 36,000 tons. GOLD'n GRO fertilizer production in 2004 utilized about 5 percent of planned capacity. Planned expansions to achieve the 36,000 ton volume include increasing both dry raw material and liquid storage, increasing tank truck loading capacity, and automation of certain manufacturing functions. Expansion can be achieved incrementally as fertilizer sales continue to grow.

We have developed the following eight-part approach to growth:

1. Increase sales in the established market segments.
2. Develop GOLD'n GRO fertilizer applications for more crops.
3. Expand sales to new territories.
4. Expand the GOLD'n GRO specialty fertilizer product line.
5. Complete development of and commercialize the new glass/tile products.
6. Develop and commercialize environmentally friendly metal leaching reagents for recovery of silver, gold, and other metals.
7. Continue facilities expansion and technology development.
8. Acquire established companies and/or their technologies.

Plans and status of implementing each of the growth categories is explained in more detail in the following sections.

1. Increase sales in established market segments.

We are selling into or developing applications for the three major segments. These are:

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-
- a. Specialty Agriculture which includes Avocados, Citrus, Grapes, Fruit and Nut Trees, and Vegetables.
 - b. Bulk Field Crops which include alfalfa, cereal grains, corn, cotton, and soybeans.
 - c. The Urban Market, which includes Home Lawn and Garden, Landscape Construction and Maintenance, and Nursery and Greenhouse markets, and Golf Courses.

Our primary focus is to increase bulk GOLD n GRO liquid fertilizer sales as rapidly as possible. This is being achieved by expanding sales in the Specialty Agriculture segment and in the Bulk Field Crops segment. There are on-going small package sales in the Urban Market, but these are small relative to the other two segments.

2. Develop GOLD'n GRO fertilizer applications for more crops.

Based on our experience to date, it takes approximately two to five years to develop a new fertilizer product, which includes regulatory approval. It typically takes another two to four years to achieve market acceptance of successful products, which includes field trials to demonstrate product effectiveness.

New product applications are being developed for the dairy cow feed market including young oats, alfalfa, hay, and silage corn. Trials were conducted in 2004. The nutrient content of the alfalfa was improved, in some cases to the highest quality ratings. This benefits the dairy because less nutrient supplements are required for feeding the cows, thus reducing dairy operating expenses. The amount of hay produced per acre increased up to 25 percent. Results of the corn crops are still being evaluated. The dairy cow feed market is large with more than 23 million acres of alfalfa hay being grown in the United States. We anticipate it will take another one to three years to complete development and launch these product applications.

In 2004, we began field trials in Idaho, Oregon, and Washington for applications on onions, potatoes, and winter wheat. In the second quarter of 2005, we began field trials in Rhode Island for lawn, landscape, and nursery application. Also in the second quarter, we started several new trials in California for silage corn applications.

A new GOLD'n GRO base liquid nutrition program is now being marketed. The program is called the "Gallon and a Quart" or "4 to 1" program. It calls for one gallon of GOLD n GRO base liquid for each quart of GOLD'n GRO chelated micro-nutrient used in soil applications. Field demonstrations have shown improved nutrition uptake and crop output under this cost effective program. Marketing of this program over the next two to three years is expected to produce a very substantial increase in the tonnage of GOLD'n GRO fertilizer sales.

3. Expand sales to new territories.

The GOLD'n GRO products are being sold in Arizona, California, Colorado, Idaho, Nevada, Oregon, Rhode Island, and Washington, with the majority of our sales in central California. We completed registration of select GOLD n GRO fertilizers in Idaho, Oregon and Washington during the first quarter of 2005; sales development is now underway. Two GOLD'n GRO products are registered in seven northeastern states and all of the products are registered in New York and in New Jersey with a distributor agreement signed for New Jersey. Based on our experience,

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commercial sales can be generated approximately one year after introductory sales activities are initiated. We are in the process of identifying distributors for New York and the other seven northeastern states. Each new geographic area developed will require the same procedural approach.

The expansion into the Northwest states of Idaho, Oregon and Washington is being managed by one field agronomist, who was transferred from California in 2004. Based on our experience, the cost of maintaining that position ranges from \$120,000 to \$150,000 per year. The expansion into the Northeast states is being managed by one part time person at an annual cost of approximately \$30,000. That person is also the lead person in seeking customers for our Photochemical Silver Concentrators. We plan to increase these spending levels in 2006, depending on sales support requirements.

In general, expansion to new regions of the country will require at least one field agronomist at a cost similar to that for the Northwest region. In addition, each state has varying registration requirements for product labels and costs of registration. Development of product labels is done internally using existing staff. Registration fees for each state vary widely, ranging from \$25 to \$600 per year, largely depending on how many products are registered in the particular state. For the near term, we anticipate utilizing present staff and management for corporate support of the sales efforts for both existing regions and for the new regions. For the longer term, as we expand we will need to add corporate support personnel, especially a Ph.D. agronomist, to properly support sales efforts.

Our plan to expand sales in Urban Markets requires the consumer to utilize fertilizer injection equipment. This equipment provides economical, easy use of liquid fertilizers for consumer lawns and gardens. We recently added two types of fertilizer injectors to our "e" store, which is the first step into this market. Additionally, other fertilizer injectors are already available to consumers through irrigation supply stores.

4. Expand the GOLD'n GRO specialty fertilizer product line.

We are developing two new specialty products, a calcium plus magnesium fertilizer named GOLD n GRO 11-0-0+5% Ca (Calcium) and a high magnesium content fertilizer named GOLD n GRO 8-0-0+3% Mg (Magnesium), both targeting foliar and soil application. We have registered GOLD n GRO 11-0-0+5% Ca in Nevada and expect to complete registration in California in the fourth quarter of 2005. Sales development is expected to start in the first quarter of 2006. The registration of GOLD n GRO 8-0-0+3% Mg is being delayed to 2006 or 2007 to allow time to complete the introduction of GOLD n GRO 11-0-0+5% Ca in California and to complete registration in Oregon and other states where it will be sold.

We are developing a new category of repellent fertilizers that are expected to be sold at higher profit margins than our other products. The GOLD n GRO Guardian deer repellent fertilizer is an example of this type of specialty fertilizer. The U.S. market for deer repellents is believed to exceed \$50 million in annual sales. Products currently in the market have limited effectiveness so there is a real opportunity for a line of systemic products that are effective for several weeks after each application. GOLD'n GRO Guardian small plot tests have shown effectiveness for 8 to 12 weeks as well as excellent wintertime effectiveness.

In the second quarter of 2005 we acquired ownership interest in the GOLD n GRO Guardian trademark, product rights, and the repelling product. We now own 100% of all rights related to

GOLD n GRO Guardian. Results of the research of the GOLD n GRO Guardian deer repellent fertilizer has provided a basis for a bird (goose) repellent fertilizer that will be perfected for small plot field trials and registration after the registration of GOLD n GRO Guardian is underway. Currently, this product line is strictly for non-food plant

applications.

We believe the users of the GOLD n GRO deer repellent fertilizer will be upscale homeowners, commercial landscapers, and municipal facilities, and wholesale and retail nurseries. The initial sales center will be in Rhode Island.

5. Complete development of and commercialize glass/tile products.

In 2003, we developed and produced glass /tile products proving that the product concept is technically viable. When the development of the glass/ceramic tile product is completed, we will achieve the ability to recycle 100 percent of the photoliquid materials received from customers, including waste that is generated internally during fertilizer production. We have completed preliminary market research for the tile markets, but expect to do much more work to develop a plan to enter this market.

6. Develop and commercialize metal leaching reagents for recovery of silver, gold, and other metals.

In 2002 and 2003, we initiated efforts to apply our technology to extract silver from photoliquids to the mining sector. This work will be further expanded and a small pilot circuit will be established to chemically process certain categories of silver-bearing solid wastes. The gold mining sector currently uses cyanide and other toxic chemicals in their leaching process. We believe it may be possible to create and adapt new non-toxic leaching reagents and leaching procedures for processing other secondary materials and certain types of mine generated products. The specific markets for leaching reagents in gold and silver mining is large and world wide, but has not yet been studied in detail for market development. Our Technical Services Division maintains an extensive library and database of mines and mining activities worldwide, which provides us ready access to market information as we need it. Much pilot plant work, including one or more field pilot operations, must be completed before quantitative market studies can be completed.

7. Continue facilities expansion and technology development.

As fertilizer sales volume increases, we will need to increase tank truck loading capacity. With the introduction of additional bulk products and increased demand for our products, load out capacity for shipment of three more bulk products is needed. We developed a preliminary construction budget and are seeking financing so that construction can be scheduled. While we believe that we can handle expected growth in 2005 with the existing load-out module, we hope to complete construction on the new load out equipment during the first quarter of 2006.

8. Acquire established companies and/or their technologies.

To enhance our operations and market presence, we intend to acquire small established companies or their technologies. In 2005, we completed our acquisition of the GOLD n GRO Guardian

technology. We have decided to delay any further acquisitions until additional financing is obtained.

Mining Technical Services Division (Whitney & Whitney, Inc.)

Historically, this division provided consulting services to the mining industry. In August 2005, we launched an Information Portal in the Internet. This division has a two-part approach to growth:

1. Continue to provide consulting services.

2. "e-commerce" Internet Information Portal-"insidemetals.com".

Plans and status of implementing each of the growth categories is explained in more detail in the following sections.

1. Continue to provide consulting services

During the third quarter of 2004, sales of the Mining Technical Services (Whitney & Whitney, Inc.) division declined due to winding down of on-going projects and delays related to client financing for new projects. Some of the issues related to new client project start up were resolved by the clients during the third quarter of 2004 and the remaining work was completed in early 2005. The technical services satellite consulting office was closed in early May, but certain key staff members have been retained. We intend to continue a low level effort to solicit and perform technical services for mining companies and other businesses or government agencies that have mineral interests or minerals related responsibilities

2. "e-commerce" Internet Information Portal-"insidemetals.com".

In August 2005, we launched the website "insidemetals.com," an Information Portal targeting the companies and individuals interested in the mining and precious metals industry. The website will generate revenue by charging a subscription fee for monthly access to the site. Currently, the site contains an array of information about gold and companies in the gold industry. We intend to add information on other mineral sectors gradually over time.

We anticipate that mining company professionals, all government agencies with minerals related responsibilities, financial industry investment professionals, and individual investors who have an interest in investing in mining companies but who have limited mineral industry knowledge will benefit from this Information Portal. The market scope for this service is global and is accessible with a "click of a mouse" in all countries of the world through the Internet. Whitney & Whitney, Inc. has contacts throughout the world and expects that the good will generated over a period of more than 25 years will provide market support for this service.

Item 3. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act). Based upon this evaluation, our chief executive officer and chief financial

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officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.

(b) Changes in internal controls. There was no change in our internal controls or in other factors that could affect these controls during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting."

PART II- OTHER INFORMATION

Item 1. Legal Proceedings

We 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 our business. Certain lawsuits have been filed against us for collection of funds due that are delinquent, as described below. We are currently not aware of any litigation pending or threatened for any reason other than collection of funds due and already recorded. We are not aware of any additional legal proceeding or claims that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

As of September 30, 2005 total recorded liabilities of \$731,081 including accrued interest to September 30, 2005, were subject to a total of 11 separate lawsuits for the collection of the funds due. These include 8 leases totaling \$531,302 (reflected in Current Maturities of Capital Lease Obligations) plus \$65,900 in additional interest (reflected in Accrued Interest) and three trade payables totaling \$121,263 (reflected in Accounts Payable) plus \$12,616 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 additional amounts we believe is probable and is related to four cases originally seeking \$423,375; the creditors have received judgments in three of these cases and the fourth is in litigation. We will continue to accrue interest until these cases are settled or paid in full.

We estimate an additional \$10,000 interest may be reasonably possible on one case; however, we have not accrued this amount because we do not believe it is probable to be incurred. This estimate is related to one case, seeking \$35,210, that was filed in March 2003, and no further contact has taken place since then.

We have six other cases that we deem to have a remote possibility of incurring an additional unrecorded loss. These cases, originally seeking \$313,305, now have a recorded liability of \$204,613. All six cases are under negotiated payment agreements and the payments are current.

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

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Item 2. Changes in Securities and Use of Proceeds

(c) Recent Sales of Unregistered Securities:

In August 2005, we issued an aggregate of 2,500 shares of common stock valued at \$150 to John W. Whitney, our President, as compensation for services performed on our behalf in his capacity as a director of our company for the second quarter of 2005.

In August 2005, we issued shares of common stock to the following management employees for accrued interest on their unpaid salaries. Interest is paid at 12% per annum and the share price is calculated monthly using the weighted average of the closing bid prices.

| | |
|--------------------------------|-----------------------------------|
| John W. Whitney, President | 371,232 shares valued at \$28,263 |
| Michael C. Horsley, Controller | 212,538 shares valued at \$15,890 |

In August 2005, we issued an aggregate of 21,444 shares of common stock, valued at \$1,664, to one employee for accrued interest on his unpaid salary. Interest is paid at 12% per annum and the share price is calculated monthly using

the weighted average of the closing bid prices.

In August 2005, we issued an aggregate of 1,200,000 shares of common stock to John W. Whitney, our President, at \$0.075 per share for a total of \$90,000 upon the exercise of warrants. Dr. Whitney exercised the warrants by converting \$90,000 in short term loans into common stock.

We issued options to purchase an aggregate of 9,000 shares of common stock to Michael C. Horsley, our Controller, on August 1, 2005. The options are exercisable at \$0.15 per share and expire three years after grant.

We issued options to purchase an aggregate of 21,000 shares of common stock to four of our employees on August 1, 2005. The options are exercisable at \$0.15 per share and expire in three years from grant.

During the three months ended September 30, 2005, the accrued interest on the 2000 through 2002 Series Convertible Promissory Notes resulted in the granting of additional options to purchase an aggregate of 601,575 shares of common stock. The options are exercisable at prices ranging from \$0.10 to \$1.18.

Subsequent to September 30, 2005 we will issue an aggregate of 2,500 shares of common stock valued at \$175 to John W. Whitney, our President, as compensation for services performed on our behalf in his capacity as a director of our company for the third quarter of 2005.

On July 15, 2005, we entered into a Securities Purchase Agreement with four accredited investors (the "Investors") for up to an aggregate amount of (i) \$3,250,000 in secured convertible notes, and (ii) warrants to purchase 3,000,000 shares of our common stock (the "Financing"). The Financing will be completed in three separate closings. The first closing consisted of gross proceeds of \$1,250,000 less financing costs and payment of existing debt totaling \$383,800 for net proceeds of \$866,200. The second closing of the Financing took place after we filed the registration statement required to be filed pursuant to a certain Registration Rights Agreement. Upon filing of the registration statement, we received gross proceeds of \$1,000,000 less financing costs of \$140,000 for net proceeds of \$860,000. The third

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closing of the Financing will occur within five (5) business days after we have caused the Securities and Exchange Commission to declare the registration statement effective. In the third closing, we will receive gross proceeds of \$1,000,000. In January 2006 we received net proceeds of \$455,000 on gross proceeds of \$500,000 as an advance on the final closing.

The Investors received three year convertible notes (the "Notes") bearing simple interest at 8% per annum. The Notes are convertible into our common stock at a price equal to the lesser of (i) \$0.10 or (ii) 55% of the average of the lowest 3 intraday trading prices during the 20 trading day period ending one trading day before the conversion date. Further, the Investors received five year warrants to purchase a total of 2,076,923 shares of our common stock at an exercise price of \$0.15 per share. The Investors will receive warrants to acquire an additional 923,077 shares of our common stock at an exercise price \$0.15 per share at the remaining additional closing of the Financing.

As part of a finder's fee, the Placement Agent for the above Financing, Confin International, was granted a five year warrant to purchase a total of 240,000 shares of our common stock at an exercise price of \$0.15 per share. The warrant will be issued after the final closing of the Financing.

All of the above offerings and sales were deemed to be exempt under rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933, as amended. No advertising or general solicitation was employed in offering the securities. The offerings and sales were made to a limited number of persons, all of whom were accredited investors, business associates of Itronics Inc. or executive officers of Itronics Inc., and transfer was restricted by Itronics Inc. in accordance with the requirements of the Securities Act of 1933. In addition to representations by the above-referenced

persons, we have made independent determinations that all of the above-referenced persons were accredited or sophisticated investors, and that they were capable of analyzing the merits and risks of their investment, and that they understood the speculative nature of their investment. Furthermore, all of the above-referenced persons were provided with access to our Securities and Exchange Commission filings.

Except as expressly set forth above, the individuals and entities to whom we issued securities as indicated in this section of the registration statement are unaffiliated with us.

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Item 3. Defaults Upon Senior Securities

In addition to the leases that are subject to litigation, there are four leases, with a recorded liability of \$188,255, that are in default. No payments have been made for an extended period of time, and no collection action or recent contact from the creditors has occurred on these leases. 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.

In 2003 an offer was made to extend the Series 2000 Convertible Promissory Notes. The holders of \$80,000 of the Notes have not responded to the offer and that amount, plus \$59,351 in accrued interest, remains in default.

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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibit 31.1 CERTIFICATION OF PRESIDENT PURSUANT TO SECTION

302 OF THE SARBANES-OXLEY ACT OF 2002 34

Exhibit 31.2 CERTIFICATION OF CONTROLLER PURSUANT TO SECTION

302 OF THE SARBANES-OXLEY ACT OF 2002 36

Exhibit 32 CERTIFICATIONS OF PRESIDENT AND CONTROLLER

PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED

PURSUANT SECTION 906 OF THE SARBANES-OXLEY ACT

OF 2002 38

(b) Reports on Form 8-K

Following is a list of Forms 8-K filed during the three months ended September 30, 2005:

July 20, 2005 Announced the signing of a \$3.25 million callable secured convertible note financing.

August 8, 2005

Announced second quarter and year to date fertilizer sales.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ITRONICS INC.

DATED: February 6, 2006

By: /S/JOHN W. WHITNEY

John W. Whitney

President

(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated

DATED: February 6, 2006

By: /S/JOHN W. WHITNEY

John W. Whitney

President

(Principal Executive Officer)

DATED: February 6, 2006

By: /S/MICHAEL C. HORSLEY

Michael C. Horsley

Controller

(Principal Accounting Officer)

