

ITRONICS INC
Form 10QSB
November 20, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2006

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
incorporation or organization)

(IRS Employer Identification Number)

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

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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 November 1, 2006, 262,582,597 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, 2006 AND DECEMBER 31, 2005
(UNAUDITED)

ASSETS

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| | September 30, | December 31, |
|--|---------------|--------------|
| | <u>2006</u> | <u>2005</u> |
| CURRENT ASSETS | | |
| Cash | \$ 27,707 | \$ 24,260 |
| Accounts receivable, less allowance for doubtful accounts, 2006, \$4,600; 2005, \$7,600 | 53,429 | 21,164 |
| Marketable securities, available for sale | - | 91,758 |
| Inventories | 573,194 | 592,098 |
| Prepaid expenses | 73,299 | 94,447 |
| Total Current Assets | 727,629 | 823,727 |
| PROPERTY AND EQUIPMENT | | |
| Land | 215,000 | 215,000 |
| Building and improvements | 1,167,315 | 1,167,315 |
| Design and construction in progress, manufacturing facility | 102,547 | 153,896 |
| Equipment and furniture | 2,388,275 | 2,302,984 |
| Vehicles | 200,557 | 200,557 |
| Equipment under capital lease—equipment and furniture | 847,105 | 851,952 |
| Equipment under capital lease—vehicles | 21,741 | 21,741 |
| | 4,942,540 | 4,913,445 |
| Less: Accumulated depreciation and amortization | 2,074,567 | 1,903,525 |
| | 2,867,973 | 3,009,920 |
| OTHER ASSETS | | |

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| | | |
|---|-------------|-------------|
| Intangibles | 76,500 | 76,500 |
| Deferred loan fees, net of amortization | 342,223 | 311,362 |
| Deposits | 8,108 | 8,108 |
| | 426,831 | 395,970 |
| | \$4,022,433 | \$4,229,617 |

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LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

| | September 30, | December 31, |
|--|---------------|--------------|
| | <u>2006</u> | <u>2005</u> |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 490,684 | \$ 437,113 |
| Account receivable and inventory factoring | 65,000 | - |
| Accrued management salaries | 739,440 | 599,900 |
| Accrued expenses | 188,056 | 239,130 |
| Insurance contracts payable | 38,219 | 13,738 |
| Interest payable to officer/stockholders | 44,264 | 13,276 |
| Interest payable | 191,055 | 197,708 |
| Current maturities of long-term debt | 44,266 | 57,414 |
| Current maturities of capital lease obligations | 606,281 | 730,403 |
| Current maturities of advances from an officer/stockholder | 161,525 | 161,525 |
| Current maturities of capital lease due stockholder | 4,827 | 5,858 |
| Current maturities of convertible notes and accrued interest | 3,214,527 | 2,918,559 |
| Convertible debt derivative | 4,941,431 | 3,621,220 |
| Warrant and option liability | 402,766 | 134,212 |
| Other | 36,573 | 35,234 |

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| | | |
|--|--------------|--------------|
| Total Current Liabilities | 11,168,914 | 9,165,290 |
| LONG-TERM LIABILITIES | | |
| Long-term debt, less current maturities | 511,238 | 534,607 |
| Capital lease obligation, shareholder, less current maturities | - | 3,319 |
| Total Long-Term Liabilities | 511,238 | 537,926 |
| | 11,680,152 | 9,703,216 |
| STOCKHOLDERS' EQUITY (DEFICIT) | | |
| Preferred stock, par value \$0.001 per share; authorized 999,500 shares, issued and outstanding 2006, 0 shares; 2005, 0 shares | - | - |
| Common stock, par value \$0.001 per share; authorized 1,000,000,000 shares, issued and outstanding, 253,097,600 at Sept. 30, 2006; 197,148,179 at December 31, 2005 | 253,098 | 197,148 |
| Additional paid-in capital | 22,476,592 | 21,646,307 |
| Accumulated deficit | (30,960,383) | (27,851,571) |
| Common stock to be issued | 568,680 | 573,993 |
| Accumulated other comprehensive income (loss) | - | (39,889) |
| Common stock options outstanding, net | 4,294 | 413 |
| | (7,657,719) | (5,473,599) |
| | \$ 4,022,433 | \$ 4,229,617 |

See Notes to Condensed Consolidated Financial Statements

ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(UNAUDITED)

| | Three Months Ended Sept 30, | | Nine Months Ended Sept 30, | |
|---|-----------------------------|-------------|----------------------------|-------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| REVENUES | | | | |
| GOLD n GRO fertilizer | \$294,849 | \$ 231,166 | \$1,393,223 | \$1,015,007 |
| Mining technical services | 3,300 | 12,230 | 25,211 | 44,094 |
| Total Revenues | 298,149 | 243,396 | 1,418,434 | 1,059,101 |
| COST OF REVENUES (exclusive of depreciation and amortization shown separately below) | | | | |
| GOLD n GRO fertilizer | 303,080 | 279,011 | 1,267,654 | 1,084,298 |
| Mining technical services | 6,951 | 15,698 | 29,616 | 56,581 |
| Total Cost of Revenues | 310,031 | 294,709 | 1,297,270 | 1,140,879 |
| Gross Profit (Loss) (exclusive of depreciation and amortization shown separately below) | | | | |
| | (11,882) | (51,313) | 121,164 | (81,778) |
| OPERATING EXPENSES | | | | |
| Depreciation and amortization | 57,414 | 61,903 | 171,042 | 185,413 |
| Research and development | 80,106 | 64,313 | 221,101 | 197,969 |
| Sales and marketing | 182,118 | 214,325 | 543,198 | 739,596 |

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| | | | | |
|--|---------------|---------------|---------------|---------------|
| Delivery and warehousing | 19,186 | 9,366 | 89,298 | 62,357 |
| General and administrative | 232,843 | 204,381 | 688,405 | 689,950 |
| Total Operating Expenses | 571,667 | 554,288 | 1,713,044 | 1,875,285 |
| Operating (Loss) | (583,549) | (605,601) | (1,591,880) | (1,957,063) |
| OTHER INCOME (EXPENSE) | | | | |
| Interest expense | (297,204) | (235,442) | (884,347) | (608,590) |
| Gain (loss) on derivative instruments | (2,222,810) | (481,236) | (730,404) | (481,236) |
| Gain (loss) on sale of investments | - | - | 97,728 | (10,116) |
| Other | - | 23,607 | 91 | 25,339 |
| Total Other Income (Expense) | (2,520,014) | (693,071) | (1,516,932) | (1,074,603) |
| Income (Loss) before provision for income tax | (3,103,563) | (1,298,672) | (3,108,812) | (3,031,666) |
| Provision for income tax | - | - | - | - |
| Net Income (Loss) | (3,103,563) | (1,298,672) | (3,108,812) | (3,031,666) |
| Other comprehensive income (loss) | | | | |
| Unrealized gains (losses) on securities | - | (2,269) | 39,889 | (12,343) |
| Comprehensive Income (Loss) | \$(3,103,563) | \$(1,300,941) | \$(3,068,923) | \$(3,044,009) |
| Weighted average number of shares | | | | |
| Outstanding (1,000 s) | 246,864 | 195,625 | 219,980 | 187,671 |

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Earnings (Loss) per share, basic

and diluted \$(0.013) \$(0.007) \$(0.014) \$(0.016)

See Notes to Condensed Consolidated Financial Statements

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ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND THE YEAR ENDED DECEMBER 31, 2005

(UNAUDITED)

| | <u>COMMON STOCK</u> | | | | <u>ACCUMULATED</u> | |
|-------------------------|---------------------|---------------|-------------------|--------------------|--------------------|----------------------|
| | <u>NUMBER</u> | | <u>ADDITIONAL</u> | | <u>COMMON</u> | <u>OTHER</u> |
| | <u>OF</u> | | | <u>ACCUMULATED</u> | <u>STOCK</u> | <u>COMPREHENSIVE</u> |
| | <u>SHARES</u> | | <u>PAID-IN</u> | <u>DEFICIT</u> | <u>TO</u> | <u>INCOME</u> |
| | <u>(1,000_s)</u> | <u>AMOUNT</u> | <u>CAPITAL</u> | | <u>BE</u> | |
| | | | | | <u>ISSUED</u> | |
| Balance, Dec. 31, 2004 | 164,864 | \$164,864 | \$19,438,213 | \$(22,944,959) | \$786,426 | \$ (9,568) |
| Issue of common stock: | | | | | | |
| For cash | 12,050 | 12,050 | 590,450 | - | (32,500) | - |
| For services | 6,003 | 6,003 | 406,323 | - | (9,933) | - |
| For debt conversion | 12,893 | 12,893 | 1,114,209 | - | (170,000) | - |
| For asset acquisition | 1,338 | 1,338 | 97,112 | - | - | - |
| Net (loss) for the year | | | | | | |
| ended Dec. 31, 2005 | - | - | - | (4,906,612) | - | - |
| Other comprehensive | | | | | | |

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| | | | | | | |
|--|---------|-----------|--------------|----------------|-----------|----------|
| income for the year | | | | | | |
| ended Dec. 31, 2005 | - | - | - | - | - | (30,321) |
| Common stock options outstanding | - | - | - | - | - | - |
| 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 | 4,127 | 4,127 | 94,426 | | (5,313) | |
| For debt conversion | 51,723 | 51,723 | 728,459 | | | |
| Net (loss) for the nine months ended Sept. 30, 2006 | | | | (3,108,812) | | |
| Other comprehensive income for the 9 months ended Sept. 30, 2006 | | | | | | 39,889 |
| Common stock options outstanding | | | | | | |
| Balance, Sept. 30, 2006 | 253,098 | \$253,098 | \$22,476,592 | \$(30,960,383) | \$568,680 | \$ - |

The accompanying notes are an integral part of these financial statements

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ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(UNAUDITED)

| | Nine Months Ended Sept 30, | |
|---|----------------------------|-----------------|
| | <u>2006</u> | <u>2005</u> |
| Cash flows from operating activities | | |
| Net income (loss) | \$(3,108,812) | \$(3,031,666) |
| Adjustments to reconcile net loss to | | |
| cash used by operating activities: | | |
| Depreciation and amortization | 368,153 | 212,718 |
| Interest on convertible notes | 434,417 | 286,537 |
| (Gain) loss on derivative instruments | 730,404 | 481,236 |
| Marketable securities received for services | - | (116,193) |
| (Gain) Loss on investments | (97,728) | 10,116 |
| Addition of silver in solution inventory by | | |
| offsetting photochemical processing fees | (27,411) | (28,598) |
| Stock option compensation | 3,881 | 43,379 |
| (Gains) on debt forgiveness | - | (24,832) |
| Other | - | 2,200 |
| Expenses paid with issuance of common stock | 96,299 | 480,322 |
| (Increase) decrease in: | | |
| Trade accounts receivable | (32,265) | 86,618 |
| Inventories | 46,315 | 32,468 |
| Prepaid expenses and deposits | 589 | (25,021) |
| Increase (decrease) in: | | |

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| | | |
|---|-------------|-------------|
| Accounts payable | 82,405 | (117,678) |
| Accrued management salaries | 139,540 | 181,644 |
| Accrued expenses and contracts payable | (25,254) | (184,310) |
| Accrued interest | 24,337 | 67,360 |
| Net cash used by operating activities | (1,365,130) | (1,643,700) |
| Cash flows from investing activities: | | |
| Acquisition of property and equipment | (29,095) | (57,142) |
| Proceeds from sale of investments | 229,374 | 10,177 |
| Sale of equipment | - | 500 |
| Net cash provided (used) by investing activities | 200,279 | (46,465) |
| Cash flows from financing activities: | | |
| Proceeds from sale of stock | 7,500 | 570,000 |
| Proceeds from debt, stockholder | 10,212 | 95,000 |
| Proceeds from debt, unrelated | 1,446,167 | 2,031,200 |
| Debt issuance costs | (185,378) | (195,490) |
| Proceeds from receivable/inventory factoring, net | 65,000 | 43,548 |
| Payments on debt | (175,203) | (157,259) |
| Net cash provided by financing activities | 1,168,298 | 2,386,999 |
| Net increase (decrease) in cash | 3,447 | 696,834 |
| Cash, beginning of period | 24,260 | 5,180 |
| Cash, end of period | \$ 27,707 | \$ 702,014 |

See Notes to Condensed Consolidated Financial Statements

ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005

(UNAUDITED)

(continued)

Nine Months Ended Sept. 30,

20062005

Supplemental Disclosures of Cash Flow Information:

| | | |
|--|-----------|------------|
| Cash paid during the period for interest | \$210,982 | \$ 182,321 |
| Non-cash financing and investing activities: | | |
| Common stock issued to settle: | | |
| Accounts payable | - | 11,845 |
| Convertible notes and accrued interest | 780,182 | 867,101 |
| Debt and accrued interest - officer/stockholder | - | 90,000 |
| Common stock issued to acquire: | | |
| Equipment | - | - |
| GOLD n GRO Guardian product rights | - | 71,500 |
| Warrants issued for debt issuance costs | 17,594 | 12,042 |
| Fair value of convertible debt derivative | 479,444 | 2,361,505 |
| Fair value of warrant and option liability | 250,960 | 425,152 |
| Amounts withheld from proceeds of debt, unrelated: | | |
| Prepaid interest | - | 90,000 |
| Deferred loan costs | 33,333 | 90,000 |
| Key man life insurance | - | 20,000 |
| Short term debt and accrued interest | - | 143,800 |

| | | |
|------------------|--------|---|
| Accounts payable | 20,500 | - |
|------------------|--------|---|

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, 2006

(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, 2005. 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 \$3,108,812 during the nine months ended September 30, 2006, a working capital deficit of \$10,441,285, and a stockholders' deficit balance of \$7,657,719 as of September 30, 2006. 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, 2006 are not necessarily indicative of the results to be expected for the full year.

3. On July 15 2005, the Company arranged callable secured convertible debt (Notes) totaling \$3,250,000, bearing interest at 8%, with 3,000,000 five year \$0.15 warrants. The Notes were accompanied by a Registration Rights Agreement. During 2005, the Company received \$1,726,200, (\$2,250,000 before financing costs and prepaid interest), and issued 2,076,923 warrants. In January and February 2006 the Company received \$902,500 (\$1,000,000 before financing costs), and issued 1,423,078 warrants, which included an additional 500,000 five years warrants exercisable at \$0.15 per share.

On July 31, 2006, the Company arranged new callable secured convertible debt with the same Investors (Notes) totaling \$500,000 and received net proceeds of \$463,667. The notes bear interest at 6% and are convertible into common shares at the lesser of \$0.10 or 55% of the market price of the Company's common stock, as defined. The Noteholders also received seven year warrants to acquire 20,000,000 common shares at \$0.05 per share. The arrangement included a Securities Purchase Agreement and Registration Rights Agreement with terms similar to the financing in July 2005.

The Notes are convertible into common shares 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. The Notes are further secured by 14,550,558 Company common shares owned by an officer/stockholder.

The Notes have an additional provision that the

ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006

(UNAUDITED)

Company may redeem the debt prior to maturity by paying all outstanding balances plus a 50% prepayment penalty.

The Notes are potentially convertible into an unlimited number of common shares. 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 feature and the prepayment penalty to be treated as embedded derivatives, to be recorded as a liability equal to the estimated fair value of the embedded derivatives. In addition, all non-employee warrants and options that are exercisable during the period that the Notes are outstanding are required to be recorded as liabilities at their fair value. As of September 30, 2006 the Notes were convertible into 333,836,253 common shares and the embedded derivatives had an estimated fair value of \$4,941,431. The actual carrying amount of principal and accrued interest due as of September 30, 2006 is \$3,090,767. Non-employee warrants and options to acquire a total of 39,668,801 common shares were outstanding at September 30, 2006 and had an estimated fair value of \$402,766. The fair value of the conversion feature and the prepayment penalty were estimated using the Black-Scholes option pricing model and taking a weighted average value based on various probabilities that the debt would be paid off prior to maturity at specified dates and therefore incurring the prepayment penalty. The fair value of 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 monthly basis, beginning October 2006, 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 86% to 107%, and using risk free interest rates ranging from 4.5% to 4.875%. The estimated fair value of the options exceeded the carrying value of the Notes in 2005; therefore, the excess was recorded as a loss on derivative instruments in the Consolidated Statements of Operations in 2005. The estimated fair value of the embedded derivatives and the non-employee warrants and options increased during the three and nine months ended September 30, 2006, resulting in a loss on derivative instruments of \$2,222,810 and \$730,404 for the respective periods reported in the Condensed Consolidated Statement of Operations. The fair value of the embedded derivatives, 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 are likely to occur in future periods.

Concurrently, the Company entered into a Registration Rights Agreement with the Noteholders that required the Company to have an effective registration statement within 120 days of funding, or use its best efforts to do so. Additionally, because at the inception of the Agreement the Company did not have enough authorized shares to allow the Noteholders to convert the Notes into common stock, the Agreement required the Company to increase the authorized shares prior to October 31, 2005 or use its best efforts to do so. The Agreement specifies penalties of 2% per month for failing to register the shares on a timely basis and 3% per month for failing to increase the authorized

shares. The Company completed registration of 50 million shares in February 2006 and increased the authorized shares in March 2006. Additionally,

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006

(UNAUDITED)

under the terms of the Agreement, the Company is required to register a total of two times the estimated number of shares to allow the Noteholders to convert the outstanding balance, as early as practicable, so it was possible that the 2% per month registration penalty could continue after March 31, 2006 until a new registration statement for the required number of shares becomes effective. In August 2006, we signed a letter agreement with the Investors amending the Registration Rights Agreements (Agreements) for each of the previous closings. The amendment stipulates that as long as we register 75 million common shares and comply with the time requirements specified in the Agreements, there will be no liquidated damages. In October 2006 we completed the registration of an additional 75 million common shares, thereby eliminating the potential penalties described above.

The Notes require quarterly interest payments and we estimate that \$62,110 and \$56,519 were due during the quarters ended June 30, 2006 and September 30, 2006, respectively. These payments were not paid. The Notes provide for a default penalty rate of 15% on unpaid amounts. The Company has not accrued the estimated penalty of \$4,992 as we do not believe it is probable to be incurred. In estimating the fair value of the embedded derivatives discussed above, we assumed the interest will ultimately be converted into common stock under the same terms as for the principal amount of the debt.

During the period of February 15, 2006 to September 30, 2006, the Investors converted a total of \$809,404 of the Notes into 51.7 million common shares. Subsequent to September 30, 2006 the Investors converted a total of \$116,880 of the Notes into 12 million common shares.

On November 3, 2006, the Company arranged new callable secured convertible debt with the same Investors (Notes) totaling \$500,000 and received net proceeds of \$495,000. The Notes bear interest at 6% and are convertible into common shares at the lesser of \$0.10 or 55% of the market price of the Company's common stock, as defined. The Noteholders also received seven year warrants to acquire 20,000,000 common shares at \$0.04 per share. The arrangement included a Securities Purchase Agreement and Registration Rights Agreement with terms similar to the financing in July 2005.

4.

As of September 30, 2006 total recorded liabilities of \$661,600 including accrued interest to September 30, 2006, were subject to various lawsuits and claims for the collection of the funds due. These include 15 leases totaling \$504,523 (reflected in Current Maturities of Capital Lease Obligations) plus \$43,400 in additional interest (reflected in Accrued Interest) and two trade payables totaling \$92,697 (reflected in Accounts Payable) plus \$20,480 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 are probable and are related to three cases originally seeking \$251,522. 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.

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006

(UNAUDITED)

The Company estimates an additional \$12,500 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. No further contact has taken place since then.

The Company has a total of 11 cases, that originally sought \$471,655, that we deem to have a remote possibility of incurring an additional unrecorded loss. We have negotiated payment agreements on these cases and, as of September 30, 2006, the recorded liability for these cases was \$308,965. A group of these cases, with a recorded liability of \$103,694, were due to be paid off in September 2006 under the respective settlement agreements. The law firm handling these cases has verbally agreed to extend the payment period by accepting \$21,000 per month until paid. As of September 30, 2006, \$5,000 was paid on the September payment, but subsequently, the payments were paid through November 2006.

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

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 above. We are 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.

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 September 30, 2006 is \$3,214,527. The Company is formulating a plan to seek extensions of these notes. No collection action has been taken to date.

In addition to the above leases that are subject to litigation, there are four leases, with a recorded liability of \$181,420, 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. During the nine months ended September 30, 2006 the Company began paying on one of these leases with a recorded liability of \$39,491. It is reasonably possible that additional interest of approximately \$7,600 could be incurred, but this has not been recorded because the Company does not believe it is probable to be incurred.

6. Following is a summary of finished goods, work in progress, and raw materials inventories as of September 30, 2006 and December 31, 2005. The raw material and work in progress balances below include \$332,986 and \$374,042

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in silver bearing unprocessed photochemicals or partially processed materials as of September 30, 2006 and December 31, 2005, respectively.

| | <u>Sept. 30,</u> | <u>Dec. 31,</u> |
|------------------|------------------|-----------------|
| | <u>2006</u> | <u>2005</u> |
| Finished goods | \$ 34,207 | \$ 53,274 |
| Work in progress | 307,300 | 282,373 |
| Raw materials | 231,687 | 256,451 |
| | \$573,194 | \$592,098 |

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, 2005 through September 30, 2006:

| | <u>Warrants</u> | <u>Convertible Debt Options</u> | <u>Employee Options</u> | <u>Total</u> |
|---------------------------------|-----------------|-------------------------------------|-----------------------------|--------------|
| Under option, December 31, 2004 | 20,596,809 | 25,301,659 | 5,995,000 | 51,893,468 |
| Granted | 10,943,077 | 118,189,457 | 165,000 | 129,297,534 |
| Exercised | (1,200,000) | (8,667,737) | - | (9,867,737) |
| Expired | (3,026,626) | - | (52,000) | (3,078,626) |
| Under option, December 31, 2005 | 27,313,260 | 134,823,379 | 6,108,000 | 168,244,639 |

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| | | | | |
|------------------------------|-------------|--------------|-----------|--------------|
| Granted | 21,496,924 | 272,965,067 | 196,000 | 294,657,991 |
| Exercised | (100,000) | (51,722,642) | - | (51,822,642) |
| Expired | (9,041,383) | (22,229,551) | (12,000) | (31,282,934) |
| Under option, Sept. 30, 2006 | 39,668,801 | 333,836,253 | 6,292,000 | 379,797,054 |

The average price for all warrants and options granted and exercised was \$0.019 for the nine months ended September 30, 2006 and \$0.0334 for the year ended December 31, 2005. The above warrants and options would dilute future Earnings Per Share (EPS).

The 22,229,551 in expired convertible debt options 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 expired.

The following table summarizes the warrants and options outstanding as of September 30, 2006:

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| <u>Expiration Dates</u> | <u>No. of Shares</u> | <u>Exercise Price</u> | <u>Weighted Average Exercise Price</u> |
|----------------------------|----------------------|-----------------------|--|
| <u>Warrants:</u> | | | |
| July 2013 | 20,000,000 | 0.050 | |
| March 2007 to May 2009 | 3,000,000 | 0.100 | |
| December 2007 to June 2008 | 7,575,000 | 0.150 | |
| July 2010 to February 2011 | 3,740,001 | 0.150 | |

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| | | | |
|----------------------------------|-------------|----------|----------|
| October 2006 | 44,300 | 0.171 | |
| February 2007 | 360,000 | 0.238 | |
| July 2006 to February 2007 | 2,462,500 | 0.240 | |
| January 2007 to February 2007 | 935,000 | 0.300 | |
| February 2007 to March 2007 | 1,552,000 | 0.375 | |
| Total Warrants | 39,668,801 | | \$0.1145 |
| <u>Convertible Debt Options:</u> | | | |
| July 2008 to July 2009 | 333,836,253 | \$0.0093 | \$0.0093 |
| <u>Employee Options:</u> | | | |
| August 2007 to February 2016 | 350,000 | \$0.150 | |
| One year after employment ends | 1,600,000 | 0.150 | |
| October 2007 | 250,000 | 0.200 | |
| January 2015 to August 2016 | 75,000 | 0.200 | |
| One year after employment ends | 1,000,000 | 0.250 | |
| One year after employment ends | 3,000,000 | 0.300 | |
| October 2012 to October 2013 | 17,000 | 0.500 | |
| Total Employee Options | 6,292,000 | | \$0.2409 |
| Total Warrants and Options | 379,797,054 | | \$0.0241 |

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The 333,836,253 convertible debt options listed above are related to the callable secured convertible debt discussed in Note 3 above. As of September 30, 2006 \$2,940,596 of principal and \$150,171 in accrued interest were convertible into common stock at the lower of \$0.10 per share or 55% of a calculated market price. Consequently, the number of shares and the conversion price can vary up or down materially, depending on the Company's stock price at any point in time.

8. Income (Loss) per Common Share:

Income (Loss) per common share is calculated based on the consolidated net income (loss) for the period divided by the weighted average number of common shares outstanding during 2006 and 2005. For purposes of computing diluted income per share, common stock equivalents are excluded for periods with net losses as their effect would be antidilutive.

Following is a reconciliation of Net Income (Loss) and Weighted average number of shares outstanding, in the computation of earnings (loss) per share (EPS) for the three and nine months ended September 30, 2006 and 2005.

| | Three months Ended Sept. 30, | | Nine months Ended Sept. 30, | |
|--|------------------------------|---------------|-----------------------------|---------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Net Income (Loss) | \$(3,103,563) | \$(1,298,672) | \$(3,108,812) | \$(3,031,666) |
| Less: Preferred stock dividends | - | - | - | - |
| Basic and diluted EPS income (loss) available to common stockholders | \$(3,103,563) | \$(1,298,672) | \$(3,108,812) | \$(3,031,666) |
| Weighted average number of shares outstanding (1,000 s) | 246,864 | 195,625 | 219,980 | 187,671 |
| Common equivalent shares (1,000 s) | N/A | N/A | N/A | N/A |
| Diluted average number of shares outstanding (1,000 s) | 246,864 | 195,625 | 219,980 | 187,671 |
| (Loss) Per share amount -basic | \$(0.013) | \$(0.007) | \$(0.014) | \$(0.016) |
| (Loss) Per share amount- diluted | \$(0.013) | \$(0.007) | \$(0.014) | \$(0.016) |

9. The Company adopted the provisions of SFAS 123(R), *Share-Based Payments*, on January 1, 2006. Accordingly, compensation costs for all share-based awards to employees are measured based on the grant date fair value of those awards and recognized over the period during which the employee is required to perform

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service in exchange for the award (generally over the vesting period of the award). We have no awards with market or performance conditions. Effective January 1, 2006 and for all periods subsequent to that date, SFAS 123(R) supersedes our previous accounting under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified prospective transition method, which provides for certain changes to the method for valuing share-based compensation. The valuation provisions of SFAS 123(R) apply to new awards and to awards that are outstanding at the effective date and subsequently modified or cancelled. Estimated compensation expense for awards outstanding at the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Our consolidated financial statements for the three and nine months ended September 30, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, our consolidated financial statements for prior periods were not restated to reflect, and do not include, the impact of SFAS 123(R).

Share-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Share-based compensation expense recognized in our consolidated statement of operations for the three and nine months ended September 30, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123. For share awards granted prior to 2006, expenses are amortized under the straight-line method prescribed by SFAS 123. As share-based compensation expense recognized in the consolidated statements of operations for the three and nine months ended September 30, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on our evaluation of our present employees with unvested options, we estimated no forfeitures.

Total estimated share-based compensation expense recognized under SFAS 123R for the three and nine months ended September 30, 2006 was \$591 and \$3,881 and is included in general and administrative expenses.

Through 2005, we accounted for share-based awards to employees using the intrinsic value method in accordance with APB 25 and related interpretations and provided the required pro forma disclosures of SFAS 123. Pro forma adjustments to our consolidated net loss and loss per share for the three and nine months ended September 30, 2005 were as follows:

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ITRONICS INC. AND SUBSIDIARIES

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(UNAUDITED)

| | Three Months Ended Sept. 30, <u>2005</u> | Nine Months Ended Sept. 30 <u>2005</u> |
|-----------------------------------|--|--|
| Option Compensation Expense: | | |
| As reported | \$ 6,267 | \$43,379 |
| Adjustment for additional expense | | |
| for fair value of options | 1,588 | 5,343 |
| Pro forma | \$ 7,855 | \$48,722 |
| Net Income (Loss): | | |
| As reported | \$(1,298,672) | \$(3,031,666) |
| Adjustment for additional expense | | |
| for fair value of options | (1,588) | (5,343) |
| Pro forma | \$(1,300,260) | \$(3,037,009) |
| Earnings (Loss) per share, | | |

basic and diluted

| | | |
|-------------|-----------|-----------|
| As reported | \$(0.007) | \$(0.016) |
| Pro forma | \$(0.007) | \$(0.016) |

10. Following is financial information for each of the Company's segments. No changes have occurred in the basis of segmentation since December 31, 2005.

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:

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| | Three Months Ended Sept. 30, | | Nine Months Ended Sept. 30, | |
|---------------------------|------------------------------|-------------|-----------------------------|-------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Revenues: | | | | |
| Photochemical Fertilizer | \$ 294,849 | \$ 231,166 | \$1,393,223 | \$1,015,007 |
| Mining Technical Services | 3,300 | 12,230 | 25,211 | 44,094 |
| Consolidated Revenues | \$ 298,149 | \$ 243,396 | \$1,418,434 | \$1,059,101 |
| Gross Profit (Loss): | | | | |
| Photochemical Fertilizer | \$ (8,231) | \$(47,845) | \$125,569 | \$(69,291) |
| Mining Technical Services | (3,651) | (3,468) | (4,405) | (12,487) |

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| | | | | |
|---------------------------------|----------------|----------------|----------------|----------------|
| Consolidated Gross Profit | | | | |
| (Loss) | \$ (11,882) | \$ (51,313) | \$ 121,164 | \$ (81,778) |
| Operating Income (Loss): | | | | |
| Photochemical Fertilizer | \$ (440,231) | \$ (494,166) | \$ (1,209,785) | \$ (1,584,599) |
| Mining Technical Services | (143,318) | (111,435) | (382,095) | (372,464) |
| Consolidated Operating | | | | |
| Income (Loss) | \$ (583,549) | \$ (605,601) | \$ (1,591,880) | \$ (1,957,063) |
| Other Income (Expense): | | | | |
| Photochemical Fertilizer | \$ (2,520,014) | \$ (691,842) | \$ (1,614,751) | (1,064,990) |
| Mining Technical Services | - | (1,229) | 97,819 | (9,613) |
| Consolidated Other Income | | | | |
| (Expense) | \$ (2,520,014) | \$ (693,071) | \$ (1,516,932) | \$ (1,074,603) |
| Net Income (Loss) before taxes: | | | | |
| Photochemical Fertilizer | \$ (2,960,245) | \$ (1,186,008) | \$ (2,824,536) | \$ (2,649,589) |
| Mining Technical Services | (143,318) | (112,664) | (284,276) | (382,077) |
| Consolidated Net Income | | | | |
| (Loss) before taxes | \$ (3,103,563) | \$ (1,298,672) | \$ (3,108,812) | \$ (3,031,666) |

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

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| | Sept. 30, | December 31, |
|---------------------------------|--------------|--------------|
| | <u>2006</u> | <u>2005</u> |
| Current Assets: | | |
| GOLD n GRO Fertilizer | \$701,860 | \$659,320 |
| Mining Technical Services | 6,309 | 112,085 |
| | 708,169 | 771,405 |
| Property and Equipment, net: | | |
| GOLD n GRO Fertilizer | 2,776,873 | 2,907,887 |
| Mining Technical Services | 91,100 | 102,033 |
| | 2,867,973 | 3,009,920 |
| Other Assets, net: | | |
| GOLD n GRO Fertilizer | 112,389 | 114,828 |
| Mining Technical Services | (12,159) | 349,735 |
| | 100,230 | 464,563 |
| Total Assets: | | |
| GOLD n GRO Fertilizer | 3,591,122 | 3,682,035 |
| Mining Technical Services | 85,250 | 563,853 |
| Total Segment Assets | 3,676,372 | 4,245,888 |
| Itronics Inc. assets | 26,224,259 | 25,175,867 |
| Less: inter-company elimination | (25,878,198) | (25,192,138) |
| Consolidated Assets | \$4,022,433 | \$ 4,229,617 |

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11. The Company held 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. The Company had Accumulated Unrealized Holding Gains of \$-0- at September 30, 2006 and Losses of \$39,889 at December 31, 2005. No losses were reclassified out of accumulated other comprehensive income into earnings during the three months ended September 30, 2006. Losses of \$40,360 and gains of \$471 were reclassified out of accumulated other comprehensive income into earnings during the nine months ended September 30, 2006. No gains were reclassified out of accumulated other comprehensive income into earnings during the three and nine months ended September 30, 2005. 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>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Unrealized holding gains (losses) | | | | |
| arising during the period | \$ - | \$(2,269) | \$ - | \$(20,312) |
| Reclassification adjustment | - | - | 39,889 | 7,969 |
| Other Comprehensive Income (Loss) | \$ - | \$(2,269) | \$ 39,889 | \$(12,343) |

-

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

:

| | Three Months Ended | Nine Months Ended |
|--|--------------------|-------------------|
| | September 30, | September 30, |

| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
|--|-------------|-------------|-------------|-------------|
| Gross proceeds from sale of securities | \$ - | \$ - | \$229,374 | \$ 10,177 |
| Gross gains from sale of securities | \$ - | \$ - | \$ 97,728 | \$ - |
| Gross losses from sale of securities | - | - | - | (10,116) |
| Net Gains (Losses) from sale of Securities | \$ - | \$ - | \$ 97,728 | \$(10,116) |

-
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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 \$298,149 for the quarter ended September 30, 2006, compared to \$243,396 for the prior year quarter, an increase of 22%. The increase was due to an increase in GOLD n GRO Fertilizer segment revenue of \$63,700, or 28%, which was partially offset by a decrease of \$8,900 in Mining Technical Services segment revenues, a decrease of 73%. The consolidated net loss was \$3,103,563, or \$0.013 per share, for the quarter ended September 30, 2006, compared to a net loss of \$1,298,672 or \$0.007 per share for the comparable 2005 period, an increased loss of \$1,804,900. Consolidated revenues for the first nine months of 2006 were \$1,418,434 compared to \$1,059,101 for the prior year period, an increase of 34%. The consolidated net loss was \$3,108,812 or \$0.014 per share, for the nine months ended September 30, 2006, compared to a net loss of \$3,031,666 or \$0.016 per share for the comparable 2005 period, an increased loss of \$77,100, or 3%.

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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.

GOLD n GRO FERTILIZER

| | Three months Ended Sept 30, | | Nine Months Ended Sept 30, | |
|--------------------------------|-----------------------------|-------------|----------------------------|-------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Revenues | | | | |
| Fertilizer | \$ 145,828 | \$ 107,378 | \$ 1,046,103 | \$ 803,276 |
| Photochemical recycling | 22,953 | 59,699 | 60,310 | 101,768 |
| Silver | 126,068 | 64,089 | 286,810 | 109,963 |
| Total Revenue | 294,849 | 231,166 | 1,393,223 | 1,015,007 |
| Gross profit (loss) | (8,231) | (47,845) | 125,569 | (69,291) |
| Operating income (loss) | (440,231) | (494,166) | (1,209,785) | (1,584,599) |
| Other income (loss) | (2,520,014) | (691,842) | (1,614,751) | (1,064,990) |
| Net income (loss) before taxes | (2,960,245) | (1,186,008) | (2,824,536) | (2,649,589) |

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Total segment revenues for the third quarter of 2006 were approximately \$294,800, an increase of 28% from the prior year third quarter. Total fertilizer sales for the quarter were \$145,800 (219 tons), compared to \$107,400 (187 tons) for the 2005 third quarter, an increase of 36% in dollars and an increase of 17% in tonnage. Sales of bulk Chelated Liquid Micro-nutrients were \$93,700 (108 tons) and \$68,400 (94 tons) for the third quarter of 2006 and 2005, respectively, an increase of 37% in dollars and an increase of 15% in tonnage. Sales of bulk Chelated Liquid Multi-nutrients were \$41,300 (110 tons) and \$31,300 (93 tons) for the third quarter of 2006 and 2005, respectively, an increase of 32% in dollars and 18% in tonnage. A new Chelated Secondary Nutrient product was introduced in the second quarter of 2006 and resulted in sales of just over 1 ton in the third quarter of 2006. The overall increase was due to a combination of price increases of the GOLD n GRO fertilizers, sale of a greater volume of products in all categories, and a shift in sales efforts toward higher value products. Total photochemical recycling revenue for the quarter decreased \$36,700 due to the prior year sale of a Photochemical Silver Concentrator for \$42,000. Excluding the sale of the Concentrator, recycling revenue increased 30% on an increased volume of 15% from the third quarter of 2005, due to a new customer we began serving in August 2006. Silver sales were \$126,100 (10,352 ounces) for the quarter, compared to \$64,100 (8,380 ounces) for the prior year third quarter, an increase of 97% in dollars and 24% in ounces. The increase is primarily from increased sales of processed silver bullion due to both increased production and to a rapidly increasing silver price.

Cost of sales increased \$24,100 due primarily to increases in payroll and related benefits and repair and maintenance costs. The segment recorded a gross loss of \$8,200 for the quarter, compared to a gross loss of \$47,800 for the third quarter of 2005, a decreased gross loss of \$39,600, or 83%.

In 2005 we had a significant decrease in used photochemical volume compared to 2004 volumes due to the termination of a major photochemical recycling contract in December 2004. 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. We are now aggressively seeking new large scale photochemical recycling customers. In August 2006 we obtained a new customer whose photochemical raw material is expected to significantly increase raw material supply. In November 2006 we obtained a second large scale customer. The addition of these two customers is expected to increase photochemical raw material (on an unconcentrated basis) to a level about 50% greater than the volume at the end of 2004.

We have also initiated discussions with other large scale potential customers. We anticipate that the new customers, along with our existing suppliers, will provide sufficient raw material for fertilizer production into the spring 2007 fertilizer season. If we are successful in gaining some of the other potential customers, we expect raw material needs to be met well into the future.

Segment operating expenses decreased \$14,300 from the third quarter of 2005. This resulted from a decrease in sales and marketing expenses of \$33,500 due to reduced corporate marketing.

These factors resulted in a 2006 third quarter segment operating loss of \$440,200 compared to a loss of \$494,200 for the third quarter of 2005, a decreased operating loss of \$53,900, or 11%.

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Other income (expenses) were \$(2,520,000) for the quarter, compared to \$(691,800) for the 2005 third quarter, an increased loss of \$1,828,200. The increased loss is due to a loss on derivative instruments of \$2,222,800, compared to a loss of \$481,200 in the 2005 third quarter, and to increased interest expense of \$61,800. Both items are related to the 2005 and 2006 combined borrowing of \$3,750,000 in callable secured convertible notes. The gain or loss on derivatives discussed above is calculated each quarter and is subject to material changes, either up or down, based on changes in our stock price, which is highly volatile. This financing and the related accounting treatment are more fully discussed in Note 3 to the Condensed Consolidated Financial Statements above.

The changes in operating loss and other expenses resulted in a segment net loss before taxes of \$2,960,200 for the quarter ended September 30, 2006, compared to a loss of \$1,186,000 for the prior year quarter, an increased loss of \$1,774,200, or 150%.

For the first nine months of 2006, segment revenues were \$1,393,200, compared to \$1,015,000 for the comparable 2005 period, an increase of 37%. Total fertilizer sales for the nine months ended September 30, 2006 were \$1,046,100 (1,396 tons), compared to \$803,300 (1,324 tons) for the 2005 comparable period, an increase of 30% in dollars and 5% in tonnage. Total photochemical recycling revenue for the nine months ended September 30, 2006 decreased \$41,500 due to the prior year sale of a Photochemical Silver Concentrator for \$42,000. Excluding the sale of the Concentrator, recycling revenue increased 1% on a decreased volume of 7% from the first nine months of 2005. Silver sales were \$286,800 (25,876 ounces) for the first nine months of 2006, compared to \$110,000 (13,760 ounces) for the prior year comparable period, an increase of 161% in dollars and 88% in ounces. The increase is primarily from increased sales of processed silver bullion due to both increased production and to a rapidly increasing silver price.

Gross profit for the first nine months of 2006 was \$125,600, compared to a gross loss of \$69,300 for the comparable prior year period, an improvement of \$194,900. Operating loss for the first nine months of 2006 was approximately \$1,209,800 compared to 1,584,600 for the first nine months of 2005, a decreased loss of \$374,800, or 24%.

Other income (expense) was \$(1,614,800) for the first nine months of 2006, compared to \$(1,065,000) for the comparable 2005 period. The increased loss of \$549,800 is due to an increased loss on derivative instruments of \$249,200 and by an increase in interest expense of \$275,800. Both items are related to the 2005 and 2006 combined borrowing of \$3,750,000 in callable secured convertible notes. The gain or loss on derivatives discussed above is calculated each quarter and is subject to material changes, either up or down, based on changes in our stock price, which is highly volatile.

The changes in operating loss and other expenses resulted in a segment net loss before taxes of \$2,824,500 for the nine months ended September 30, 2006, compared to a loss of \$2,649,600 for the prior year period, an increased loss of \$174,900, or 7%.

MINING TECHNICAL SERVICES

| | Three Months Ended Sept 30, | | Nine Months Ended Sept 30, | |
|--------------------------------|--------------------------------|-------------|----------------------------|-------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Revenues | \$ 3,300 | \$ 12,230 | \$ 25,211 | \$ 44,094 |
| Gross profit (loss) | (3,651) | (3,468) | (4,405) | (12,487) |
| Operating income (loss) | (143,318) | (111,435) | (382,095) | (372,464) |
| Other income (expense) | - | (1,229) | 97,819 | (9,613) |
| Net income (loss) before taxes | (143,318) | (112,664) | (284,276) | (382,077) |

Mining technical services revenue was \$3,300 for the quarter ended September 30, 2006, compared to \$12,200 for the comparable quarter of 2005, a decrease of 73%. Cost of sales decreased by \$8,700, due primarily to decreases of payroll and rent expenses due to the closing of the segment's satellite office in May 2005. These factors resulted in a third quarter gross loss for the segment of \$3,700 compared to \$3,500 for the prior year third quarter, a nominal increased loss.

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 GOLD n GRO fertilizer 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 GOLD n GRO fertilizer 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 months ended September 30, 2006 and 2005 we allocated costs of approximately \$57,600 and \$45,500, 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 development spending to continue into at least the first quarter of 2007. As improvements to the site are completed and information maintenance becomes routine, we will reduce or redirect staff resources as needed. In recent months traffic volume has expanded to a level that we believe makes it worthwhile for gold exploration companies to begin paid advertising on the website. A program to solicit advertising customers is being developed and will be offered to gold exploration companies beginning in the fourth quarter of 2006. To assist with the sales development program of the website, we hired a manager of marketing and sales in October 2006. He is responsible for marketing efforts for both the insidemetals.com website and for technical consulting services to the mining industry.

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Total segment operating expenses for the third quarter of 2006 increased \$31,700, due to increased research and development costs related to the insidemetals.com website discussed above and to increased general and administration costs resulting from increases in legal and accounting, insurance, and shareholder services.

The combination of these factors resulted in a 2006 third quarter segment operating loss of \$143,300, compared to an operating loss of \$111,400 for the third quarter of 2005, an increased operating loss of \$31,900, or 29%.

Other income (loss) for the third quarter of 2006 was \$-0- compared to a loss of \$1,200 for the prior year third quarter, a nominal change.

The changes in operating loss and other income resulted in a segment net loss before taxes of \$143,300 for the quarter ended September 30, 2006, compared to a loss of \$112,700 for the prior year quarter, an increased loss of \$30,700, or 27%.

For the first nine months of 2006, segment revenue totaled \$25,200 compared to \$44,100 for the first nine months of 2005, a decrease of 43%. This is primarily attributable to the ending of the Golden Phoenix Minerals, Inc. contract in March 2005. Gross loss for the first nine months of 2006 was \$4,400, compared to a gross loss of \$12,500 for the comparable prior year period, a decreased gross loss of \$8,100. Operating loss for the period was \$382,100 compared to an operating loss of \$372,500 for the comparable 2005 period, an increased operating loss of \$9,600, or 3%.

Other income (loss) for the first nine months of 2006 was a gain of \$97,800 compared to a loss of \$9,600 for the prior year period. This increase is due to increased sales at a profit of common shares of Golden Phoenix Minerals, Inc. (GPXM) As of September 30, 2006, all of the shares of GPXM have been sold.

The changes in operating loss and other income resulted in a segment net loss before taxes of \$284,300 for the nine months ended September 30, 2006, compared to a net loss of \$382,100 for the prior year period, a decreased loss of \$97,800, or 26%.

SUMMARY

On a consolidated basis the various changes in revenues and cost of revenues resulted in a gross loss of \$11,900 for the three months ended September 30, 2006, compared to \$51,300 for the prior year third quarter, an improvement of \$39,400, or 77%. Operating loss for the third quarter 2006 was \$583,500, compared to \$605,600 for the third quarter of 2005, a decreased operating loss of \$22,100, or 4%. Net loss before taxes for the third quarter 2006 was \$3,103,600

compared to a loss of \$1,298,700 for the prior year third quarter, an increased loss of \$1,804,900, or 139%. For the nine month period ended September 30, 2006 gross profit was \$121,200 compared to a gross loss of \$81,800 for the prior year comparable period, an improvement of \$202,900. Operating loss for the nine months ended September 30, 2006 was \$1,591,900 compared to \$1,957,100 for the prior year comparable period, a decreased operating loss of \$365,200, or 19%. Net loss before taxes for the nine months ended September 30, 2006 was \$3,108,800 compared to \$3,031,700 for the prior year nine month period, an increased loss of \$77,100, or 3%.

Changes in Financial Condition; Capitalization

Cash amounted to \$27,700 as of September 30, 2006, compared to \$702,000 as of September 30, 2005. Net cash used for operating activities was approximately \$1,365,100 for the first nine months of 2006. The cash used for operating activities during the period was financed primarily by net proceeds of \$1,446,200 from the issuance of callable secured convertible notes, less \$185,400 in debt issuance costs, and sale of investments of \$229,400.

Total assets decreased \$207,200 during the nine months ended September 30, 2006 to \$4,022,400. Current assets decreased \$96,100 due to decreases in marketable securities of \$91,800, inventory of \$18,900, and prepaid expenses of \$21,100. These decreases were partially offset by an increase in accounts receivable of \$32,300. Net property and equipment decreased \$141,900 due to depreciation and amortization. Other assets increased \$30,900 due to an increase in net deferred loan fees related to the callable secured convertible note financing.

Current liabilities increased during the nine months ended September 30, 2006 by \$2,003,600 and total liabilities increased by \$1,976,900. The increase is primarily due to an increase of \$1,588,800 in the estimated fair value of derivative instruments and the related callable secured convertible debt. The components of this increase include \$1,500,000 in new convertible debt borrowing, an increase in the estimated fair value of derivative instruments of \$730,400, which was partially offset by the conversion of \$780,200 of convertible debt into common stock. Other changes in current liabilities include increases of \$53,600 in accounts payable, \$65,000 in account receivable and inventory factoring, \$139,500 in accrued management salaries, and \$296,000 in current maturities of convertible notes and accrued interest. These increases were partially offset by decreases of \$51,100 in accrued expenses and \$124,100 in current maturities of capital lease obligations.

Liquidity and Capital Resources

During the nine months ended September 30, 2006, working capital decreased by \$2,099,700 to a deficit balance of \$10,441,300. The decline is due primarily to the increase in derivative instruments discussed above, as well as the changes in various current assets and liabilities as discussed above.

In July 2005 we obtained 8% convertible debt financing for a total of \$3.25 million. The final funds from this financing were received in February 2006 after our registration statement became effective. This funding provided for our capital needs through July 2006. On July 31, 2006 we obtained 6% convertible debt financing of \$500,000. This funding provided for our capital needs through October 2006. On November 3, 2006 we obtained 6% convertible debt financing of \$500,000. We expect this funding to provide for our capital needs into December 2006 or January 2007, depending on fertilizer and silver sales growth. We are actively seeking additional financing.

To meet short term cash needs, we have negotiated a 10 day payment period on invoices to our primary distributor, at a cost of 1% of the invoice amount. We also periodically factor certain inventory items and receivables to help with short term cash needs. These arrangements are with unrelated individuals, carry interest at 2% to 3% per month, and the lenders are secured by a blanket UCC on specified inventory items and on specified invoices. As of September 30, 2006, \$65,000 in factored inventory and receivables is outstanding.

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 GOLD 'n GRO Fertilizer segment 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 segment 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 GOLD 'n GRO Fertilizer segment, 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.

GOLD 'n GRO Fertilizer Segment (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 2005 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.

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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:

- 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 up to five years to develop a new fertilizer product, which includes regulatory approval. It typically takes up to an additional five 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 and 2005. 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. Several of these field trials are continuing in 2006.

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, Utah, 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, and Utah in early 2006; 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, 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, Utah, 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 2007, depending on sales support requirements.

In the second quarter of 2006, the Company made its first sale to a distributor in northern Mexico.

In general, expansion to new regions of the country will require at least one field agronomist for each region 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. In May 2006 we added a Ph.D. agronomist to the sales support staff on a part time basis. He will take the lead in conducting field trials and in accumulating/analyzing the resulting data. He will also be responsible for arranging University studies as part of an ongoing research program to develop new GOLD n GRO fertilizer applications and to improve knowledge about the effectiveness of existing GOLD n GRO fertilizers. 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 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 registered GOLD n GRO 11-0-0+5% Ca in Nevada in 2005 and completed registration in California in the first quarter of 2006. Sales development started in the second quarter of 2006. The registration of GOLD n GRO 8-0-0+3% Mg is being delayed to 2007 or 2008 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 management believes 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 crop applications.

During the second half of 2005 and through the third quarter of 2006 we have been performing research to produce a GOLD n GRO Guardian mix that will be stable for up to a year. This research has overcome a number of technical challenges and is nearing completion. A modified formulation has been perfected and tested and found to be suitable for use. Once additional test work is completed, possibly by year end 2006, the registration process can be implemented. We are seeking funds for this so that the registration process can be started during the first quarter of 2007.

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 is being expanded and a small pilot circuit is being 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 have scheduled construction of the tank foundation and containment, which will be completed by year end 2006. We are still seeking financing to purchase the tanks.

In the first quarter of 2006 the Company tripled silver recovery capacity. The Company continued to work towards implementing its new iron and sulfur leach process that reduces the amount of solids delivered to its silver refinery by 50%, effectively doubling capacity while reducing refining costs by more than half. Work is underway to size and layout a pilot leaching circuit that is planned to be partially assembled in the fourth quarter of 2006 and to begin intermittent operation in the fourth quarter of 2006. Planning also began for a further increase in silver refining capacity which will include an expansion of material drying, sampling, and preparation capacity.

We began installation of an air purification system for the refining operation early in the fourth quarter of 2006. The installation is expected to be completed by year end 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.

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

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

1. Continue to provide consulting services.

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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 May 2005, 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 and by selling advertising to gold exploration companies. 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.

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.

In recent months, traffic volume on the website has expanded to a level that we believe is sufficient to make it worthwhile for gold exploration companies to begin paid advertising on the website. A program to solicit advertising customers is being developed and will be offered to gold exploration companies beginning in the fourth quarter of 2006. To assist with the sales development program of the website, we hired a manager of marketing and sales in October 2006. He is responsible for marketing efforts for both the insidemetals.com website and for technical consulting services to the mining industry.

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 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.

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(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

As of September 30, 2006 total recorded liabilities of \$661,600 including accrued interest to September 30, 2006, were subject to various lawsuits and claims for the collection of the funds due. These include 15 leases totaling

\$504,523 (reflected in Current Maturities of Capital Lease Obligations) plus \$43,400 in additional interest (reflected in Accrued Interest) and two trade payables totaling \$92,697 (reflected in Accounts Payable) plus \$20,480 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 are probable and are related to three cases originally seeking \$251,522. The creditors have received judgments in these cases, but have taken no further collection action. We will continue to accrue interest until these cases are settled or paid in full.

We estimate an additional \$12,500 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. No further contact has taken place since then.

We have a total of 11 cases, that originally sought \$471,655, that we deem to have a remote possibility of incurring an additional unrecorded loss. We have negotiated payment agreements on these cases and, as of September 30, 2006, the recorded liability for these cases was \$308,965. A group of these cases, with a recorded liability of \$103,694, were due to be paid off in September 2006 under the respective settlement agreements. The law firm handling these cases has verbally agreed to extend the payment period by accepting \$21,000 per month until paid. As of September 30, 2006, \$5,000 was paid on the September payment, but subsequently, the payments were paid through November 2006.

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

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 above. We are 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.

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Item 2. Changes in Securities and Use of Proceeds

(c) Recent Sales of Unregistered Securities:

In July 2006, we issued an aggregate of 2,500 shares of common stock valued at \$88 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 2006.

We issued options to purchase an aggregate of 9,000 shares of common stock to Michael C. Horsley, our Controller, on August 1, 2006. The options are exercisable at \$0.15 per share and expire three years after grant.

We issued options to purchase an aggregate of 46,000 shares of common stock to five of our employees in August 2006. The options are exercisable at \$0.15 to \$0.20 per share and expire in three to ten years from grant.

In July 2006, we entered into a Securities Purchase Agreement with four accredited investors (the "Investors") for an aggregate amount of (i) \$500,000 in secured convertible notes, and (ii) warrants to purchase 20,000,000 shares of our common stock (the "Financing").

The Investors received three year convertible notes (the "Notes") bearing simple interest at 6% 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 seven year warrants to purchase a total of 20,000,000 shares of our common stock at an exercise price of \$0.05 per share.

In August 2006 we issued an aggregate 2,481,642 shares of common stock to the four Investors discussed above upon the conversion of \$15,907 in callable secured convertible notes.

In October 2006 we issued an aggregate of 2,500 shares of common stock valued at \$50 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 2006.

In October 2006, we issued an aggregate of 119,518 shares of common stock valued at \$8,000 to Duane H. Rasmussen, our Vice President, as compensation for services performed on our behalf in his capacity as Vice President of our company in part for the second quarter of 2005 and in part for periods in 2003 and prior.

In November 2006, we entered into a Securities Purchase Agreement with four accredited investors (the "Investors") for an aggregate amount of (i) \$500,000 in secured convertible notes, and (ii) warrants to purchase 20,000,000 shares of our common stock (the "Financing").

The Investors received three year convertible notes (the "Notes") bearing simple interest at 6% 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 seven year warrants to purchase a total of 20,000,000 shares of our common stock at an exercise price of \$0.04 per share.

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.

Item 3. Defaults Upon Senior Securities

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 September 30, 2006 is \$3,214,527. We are formulating a plan to seek extensions of these notes. No collection action has been taken to date.

In addition to the above leases that are subject to litigation, there are four leases, with a recorded liability of \$181,420, 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. During the nine months ended September 30, 2006 we began paying on one of these leases with a recorded liability of \$39,491. It is reasonably possible that additional interest of approximately \$7,600 could be incurred, but this has not been recorded because we do not believe it is probable to be incurred.

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Item 6. Exhibits

| | | |
|--------------|--|----|
| Exhibit 31.1 | CERTIFICATION OF PRESIDENT PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002 | 38 |
| Exhibit 31.2 | CERTIFICATION OF CONTROLLER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002 | 40 |
| 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 | 42 |

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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: November 17, 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: November 17, 2006 By: /S/JOHN W. WHITNEY

John W. Whitney
President
(Principal Executive Officer)

DATED: November 17, 2006 By: /S/MICHAEL C. HORSLEY

Michael C. Horsley
Controller
(Principal Accounting Officer)