

ITRONICS INC  
Form 10-Q  
November 14, 2008

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

(Mark One)

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

For the quarterly period ended September 30, 2008

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 registrant as specified in its charter)

TEXAS

75-2198369

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

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

(Address of principal executive offices)

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

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

Indicate by checkmark whether the registrant is a large accelerated, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ( )

Accelerated filer ( )

Non-accelerated filer ( ) (Do not check if a

Smaller reporting company (X)

Smaller reporting company)

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

As of October 31, 2008, 2,049,588,005 shares of common stock were outstanding.

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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, 2008 AND DECEMBER 31, 2007

ASSETS

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|  | Sept. 30,<br><u>2008</u> | December 31,<br><u>2007</u> |
|--|--------------------------|-----------------------------|
|  | (Unaudited)              |                             |
| CURRENT ASSETS   |                          |                             |
| Cash   | \$ -                     | \$92,987                    |
| Accounts receivable, less allowance for<br>doubtful accounts, 2008, \$4,600; 2007, \$4,600 | 52,638                   | 17,561                      |
| Inventories  | 1,064,976                | 889,996                     |
| Prepaid expenses   | 117,778                  | 94,952                      |
| Total Current Assets   | 1,235,392                | 1,095,496                   |
| PROPERTY AND EQUIPMENT   |                          |                             |
| Land   | 215,000                  | 215,000                     |
| Building and improvements  | 1,312,409                | 1,312,409                   |
| Design and construction in progress,<br>manufacturing facility                             | 116,465                  | 97,110                      |
| Equipment and furniture  | 2,881,463                | 2,879,938                   |
| Vehicles   | 222,298                  | 222,298                     |
| Equipment under capital lease—equipment and furniture                                      | 466,571                  | 466,571                     |
|  | 5,214,206                | 5,193,326                   |
| Less: Accumulated depreciation and amortization  | 2,481,811                | 2,341,004                   |
| Total Property and Equipment   | 2,732,395                | 2,852,322                   |
| OTHER ASSETS   |                          |                             |
| Intangibles  | 76,500                   | 76,500                      |

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Deferred loan fees, less accumulated amortization 2008,

|                            |             |             |
|----------------------------|-------------|-------------|
| \$457,716; 2007, \$521,727 | 241,840     | 323,042     |
| Deposits                   | 7,181       | 8,508       |
| Total Other Assets         | 325,521     | 408,050     |
|                            | \$4,293,308 | \$4,355,868 |

The accompanying notes are an integral part of these financial statements

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LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

|   | Sept. 30,<br><u>2008</u> | December 31,<br><u>2007</u> |
|---|--------------------------|-----------------------------|
|   | (Unaudited)              |                             |
| CURRENT LIABILITIES   |                          |                             |
| Bank overdraft  | \$ 24,685                | \$ -                        |
| Accounts payable  | 816,868                  | 672,163                     |
| Accrued management salaries   | 563,916                  | 779,873                     |
| Accrued expenses  | 344,138                  | 272,267                     |
| Insurance contracts payable   | 30,094                   | 13,761                      |
| Interest payable to officer/stockholders                                    | 312,525                  | 157,181                     |
| Interest payable, long-term debt and lease obligations                      | 240,960                  | 225,533                     |
| Current maturities of long-term debt  | 496,985                  | 436,523                     |
| Current maturities of capital lease obligations                             | 384,673                  | 463,996                     |
| Advances from stockholder   | 112,025                  | 143,025                     |
| Current maturities of Series 2000 convertible notes<br>and accrued interest | 3,333,574                | 3,497,838                   |
| Series 2000 convertible debt derivatives                                    | 153,462                  | -                           |

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|   |            |            |
|---|------------|------------|
| Callable secured convertible debt derivatives | 15,572,704 | 13,003,762 |
| Warrant and option liability                  | 520,852    | 231,224    |
| Other   | 121,609    | 40,498     |
| Total Current Liabilities                     | 23,029,070 | 19,937,644 |

LONG-TERM LIABILITIES

|   |            |            |
|---|------------|------------|
| Long-term debt, less current maturities   | -          | 82,197     |
| Series 2000 convertible notes and accrued interest,<br>net of<br><br>current maturities and net of \$153,462 fair value of<br>the<br><br>conversion feature at September 30, 2008 and \$-0-<br><br>at December 31, 2007 | 329,099    | -          |
| Total Long-Term Liabilities   | 329,099    | 82,197     |
| Commitments and Contingencies (see Note 4)  | -          | -          |
| Total Liabilities   | 23,358,169 | 20,019,841 |

STOCKHOLDERS' EQUITY (DEFICIT)

|   |            |            |
|---|------------|------------|
| Preferred stock, par value \$0.001 per share;<br><br>authorized 999,500 shares; issued and outstanding<br><br>2008, 0 shares; 2007, 0 shares  |            | -          |
| Common stock, par value \$0.0001 per share;<br><br>authorized 20,000,000,000 shares; issued and<br>outstanding,<br><br>1,827,988,760 at September 30, 2008 and 999,996,999<br>at<br><br>December 31, 2007 | 182,799    | 999,997    |
| Additional paid-in capital  | 26,360,185 | 24,692,645 |

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|                                     |              |              |
|-------------------------------------|--------------|--------------|
| Accumulated deficit                 | (46,907,255) | (42,143,980) |
| Common stock to be issued           | 1,299,410    | 787,365      |
| Total Stockholders Equity (Deficit) | (19,064,861) | (15,663,973) |
|                                     | \$4,293,308  | \$4,355,868  |

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

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ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(UNAUDITED)

|  | Three Months Ended Sept 30, |             | Nine Months Ended Sept 30, |             |
|--|-----------------------------|-------------|----------------------------|-------------|
|  | <u>2008</u>                 | <u>2007</u> | <u>2008</u>                | <u>2007</u> |
| REVENUES   |                             |             |                            |             |
| GOLD n GRO fertilizer  | \$ 472,124                  | \$ 533,624  | \$ 2,301,903               | 1,901,436   |
| Mining technical services  | 21,784                      | 8,329       | 108,999                    | 14,957      |
| Total Revenues   | 493,908                     | 541,953     | 2,410,902                  | 1,916,393   |
| COST OF REVENUES (exclusive of<br>depreciation and amortization<br>shown separately below) |                             |             |                            |             |
| GOLD n GRO fertilizer  | 478,761                     | 516,291     | 1,918,472                  | 1,751,031   |
| Mining technical services  | 19,753                      | 10,238      | 71,671                     | 25,968      |
| Total Cost of Revenues   | 498,514                     | 526,529     | 1,990,143                  | 1,776,999   |
| Gross Profit (Loss) (exclusive<br>of depreciation and amortization                         |                             |             |                            |             |

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|                                       |                    |                |                    |                    |
|---------------------------------------|--------------------|----------------|--------------------|--------------------|
| shown separately below)               | (4,606)            | 15,424         | 420,759            | 139,394            |
| OPERATING EXPENSES                    |                    |                |                    |                    |
| Depreciation and amortization         | 46,944             | 52,392         | 140,807            | 157,013            |
| Research and development              | 68,975             | 92,053         | 215,816            | 280,907            |
| Sales and marketing                   | 145,048            | 423,962        | 491,641            | 984,876            |
| Delivery and warehousing              | 25,937             | 20,606         | 144,742            | 111,742            |
| Stock and option compensation         | 345,690            | 11,436         | 333,216            | 13,161             |
| General and administrative            | 236,973            | 290,245        | 704,040            | 762,916            |
| Total Operating Expenses              | 869,567            | 890,694        | 2,030,262          | 2,310,615          |
| Operating (Loss)                      | (874,173)          | (875,270)      | (1,609,503)        | (2,171,221)        |
| OTHER INCOME (EXPENSE)                |                    |                |                    |                    |
| Interest expense                      | (503,836)          | (339,488)      | (1,133,163)        | (931,234)          |
| Gain (loss) on derivative instruments | (4,624,198)        | 1,762,907      | (2,107,986)        | 1,594,154          |
| Gain (loss) on sale of investments    | -                  | (3,983)        | -                  | 348,026            |
| Other                                 | 44,938             | 159            | 87,377             | 630                |
| Total Other Income (Expense)          | (5,083,096)        | 1,419,595      | (3,153,772)        | 1,011,576          |
| Income (Loss) before provision        |                    |                |                    |                    |
| <b>for income tax</b>                 | <b>(5,957,269)</b> | <b>544,325</b> | <b>(4,763,275)</b> | <b>(1,159,645)</b> |
| Provision for income tax              | -                  | -              | -                  | -                  |
| Net Income (Loss)                     | (5,957,269)        | 544,325        | (4,763,275)        | (1,159,645)        |
| Other comprehensive income (loss)     |                    |                |                    |                    |
| Unrealized gains (losses) on          |                    |                |                    |                    |
| <b>securities</b>                     | <b>-</b>           | <b>(3,115)</b> | <b>-</b>           | <b>-</b>           |



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|                                   |                |            |               |               |
|-----------------------------------|----------------|------------|---------------|---------------|
| Comprehensive Income (Loss)       | \$ (5,957,269) | \$ 541,210 | \$(4,763,275) | \$(1,159,645) |
| Weighted average number of shares |                |            |               |               |
| Outstanding (1,000 s) - Basic     | 1,560,397      | 466,067    | 1,211,448     | 407,278       |
| Diluted                           | 1,560,397      | 2,753,976  | 1,211,448     | 407,278       |
| Earnings (Loss) per share: Basic  | \$(0.004)      | \$0.001    | \$(0.004)     | \$(0.003)     |
| Diluted                           | \$(0.004)      | \$0.0002   | \$(0.004)     | \$(0.003)     |

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

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ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND THE YEAR ENDED DECEMBER 31, 2007

(UNAUDITED)

|                              | <u>COMMON STOCK</u>                     |           | COMMON                           |                        |                             |                          |               |
|------------------------------|---|-----------|----------------------------------|------------------------|-----------------------------|--------------------------|---------------|
|                              | NUMBER<br>OF<br>SHARES<br><br>(1,000 s) | AMOUNT    | ADDITIONAL<br>PAID-IN<br>CAPITAL | ACCUMULATED<br>DEFICIT | STOCK<br>TO<br>BE<br>ISSUED | STOCK<br>OPTIONS,<br>NET | TOTAL         |
| Balance,<br>Dec. 31,<br>2006 | 337,582                                 | \$337,582 | \$23,305,788                     | \$(31,661,456)         | \$ 583,868                  | \$4,713                  | \$(7,429,505) |
| Issue of<br>common<br>stock: |   |           |                                  |                        |                             |                          |               |
| For cash                     |   |           |                                  |                        |                             |                          |               |
| For services                 | 99,274                                  | 99,274    | 588,713                          | -                      | 217,097                     | -                        | 905,084       |
| For debt<br>conversion       | 555,410                                 | 555,410   | 698,057                          | -                      | (13,600)                    | -                        | 1,239,867     |

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|   |           |            |              |                |             |         |                |
|---|-----------|------------|--------------|----------------|-------------|---------|----------------|
| For asset acquisition                               | 7,731     | 7,731      | 100,087      | -              | -           | -       | 107,818        |
| Net (loss) for the year ended Dec. 31, 2007         | -         | -          | -            | (10,482,524)   | -           | -       | (10,482,524)   |
| Common stock options outstanding                    | -         | -          | -            | -              | -           | (4,713) | (4,713)        |
| Balance, Dec. 31, 2007                              | 999,997   | 999,997    | 24,692,645   | (42,143,980)   | 787,365     | -       | (15,663,973)   |
| Issue of common stock                               |           |            |              |                |             |         |                |
| For cash  | 16,667    | 1,667      | 23,333       | -              | 70,000      | -       | 95,000         |
| For services  | 88,278    | 8,828      | 206,478      | -              | 2,045       | -       | 217,351        |
| For debt conversion, related party                  | 63,333    | 6,333      | 88,667       | -              | 440,000     | -       | 535,000        |
| For debt conversion                                 | 659,714   | 65,971     | 449,065      | -              | -           | -       | 515,036        |
| Adjustment for new par value                        | -         | (899,997)  | 899,997      | -              | -           | -       | -              |
| Net income for the nine months ended Sept. 30, 2008 | -         | -          | -            | (4,763,275)    | -           | -       | (4,763,275)    |
| Balance, Sept. 30, 2008                             | 1,827,989 | \$ 182,799 | \$26,360,185 | \$(46,907,255) | \$1,299,410 | \$ -    | \$(19,064,861) |

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

ITRONICS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007

(UNAUDITED)

|   | Nine Months Ended Sept. 30, |               |
|---|-----------------------------|---------------|
|   | <u>2008</u>                 | <u>2007</u>   |
| Cash flows from operating activities              |                             |               |
| Net income (loss)                                 | \$(4,763,275)               | \$(1,159,645) |
| Adjustments to reconcile net income (loss) to     |                             |               |
| <b>cash used by operating activities:</b>         |                             |               |
| Depreciation and amortization                     | 285,809                     | 350,620       |
| Interest on convertible notes                     | 741,720                     | 507,799       |
| (Gain) loss on change in fair value of derivative |                             |               |
| <b>instruments</b>                                | 2,107,986                   | (1,594,154)   |
| (Gain) on sale of investments                     | -                           | (348,026)     |
| Addition of silver in solution inventory by       |                             |               |
| offsetting photochemical processing fees          | (206,985)                   | (253,545)     |
| Stock and option compensation                     | 333,216                     | 13,161        |
| (Gain) on debt forgiveness                        | (87,377)                    | -             |
| Bad debts   | 264                         | -             |
| Expenses paid with issuance of common stock:      |                             |               |
| Consulting expenses                               | 68,792                      | 350,155       |
| Director fees                                     | 9,000                       | 13,388        |
| Salaries  | 115,857                     | 215,607       |

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|  |           |             |
|--|-----------|-------------|
| (Increase) decrease in:                    |           |             |
| Trade accounts receivable                  | (35,341)  | (124,719)   |
| Inventories                                | 61,758    | 115,030     |
| Prepaid expenses, deposits and other       | (53,776)  | (24,930)    |
| Increase (decrease) in:                    |           |             |
| Accounts payable                           | 148,930   | 42,509      |
| Accrued management salaries                | 224,043   | 178,346     |
| Accrued expenses and other                 | 169,315   | 87,527      |
| Accrued interest                           | 188,986   | 38,364      |
| Net cash used by operating activities      | (691,078) | (1,592,513) |
| Cash flows from investing activities:      |           |             |
| Acquisition of property and equipment      | (11,224)  | (39,277)    |
| Sale of investments                        | -         | 348,026     |
| Net cash provided by investing activities  | (11,224)  | 308,749     |
| Cash flows from financing activities:      |           |             |
| Proceeds from sale of stock                | 95,000    | -           |
| Proceeds from officer/stockholder advances | 64,000    | 8,000       |
| Proceeds from debt                         | 500,000   | 1,515,000   |
| Debt issuance costs                        | (43,800)  | (102,142)   |
| Bank overdraft                             | 24,685    | (13,834)    |
| Payments on debt                           | (30,570)  | (102,956)   |
| Net cash provided by financing activities  | 609,315   | 1,304,068   |
| Net increase (decrease) in cash            | (92,987)  | 20,304      |

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|                           |        |           |
|---------------------------|--------|-----------|
| Cash, beginning of period | 92,987 | -         |
| Cash, end of period       | \$ -   | \$ 20,304 |

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, 2008 AND 2007

(UNAUDITED)

|   | Nine Months Ended Sept. 30, |             |
|---|-----------------------------|-------------|
|   | <u>2008</u>                 | <u>2007</u> |
| Supplemental Disclosures of Cash Flow Information:    |                             |             |
| Cash paid during the period for interest              | \$ 57,454                   | \$ 198,732  |
| Non-cash financing and investing activities:          |                             |             |
| Marketable securities received for sale of investment | -                           | 138,353     |
| Common stock issued to settle:                        |                             |             |
| Convertible notes                                     | 515,034                     | 633,822     |
| Accrued management salaries                           | 440,000                     | 246,000     |
| Accounts payable                                      | 4,221                       | -           |
| Short term notes-officer/stockholder                  | 95,000                      | 18,500      |
| Acquisition of assets by issuance of common stock:    |                             |             |
| Equipment   | 9,656                       | 56,818      |
| Inventory   | 29,753                      | 51,000      |
| Amounts withheld from proceeds of debt, unrelated:    |                             |             |
| Deferred loan costs                                   | 20,000                      | 70,000      |

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, 2008

(UNAUDITED)

1. The unaudited condensed consolidated financial statements presented herein have been prepared in accordance with the instructions to Form 10-Q 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, 2007. These financial statements reflect all adjustments that are, in the opinion of management, necessary to fairly state the results for the interim periods reported. All adjustments are of a normal recurring nature. 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 \$4,763,275 during the nine months ended September 30, 2008, a working capital deficit of \$21,793,678, and a stockholders' deficit balance of \$19,064,861 as of September 30, 2008. These factors indicate the Company and its subsidiaries' ability to continue in existence is dependent upon their ability to obtain additional long-term debt and/or equity financing and achieve profitable operations. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company and its subsidiaries be unable to continue in existence. The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year.

3. Beginning in July 2005, the Company has arranged a series of callable secured convertible debt financings (Notes) with an accredited investment group totaling \$6,830,000. The Notes bear interest at 12% and are due three years from issuance. In connection with these financings, the Company has issued warrants to acquire common stock in varying amounts and at varying exercise prices. During 2007 and 2008 the Company signed Notes that added accrued interest totaling \$342,170 and \$163,852 to the outstanding principal balance. These Notes bear interest at 12% and have a three year term. Following is a summary of the financings:

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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SEPTEMBER 30, 2008

(UNAUDITED)

| <u>DATE</u>                            | <u>ORIGINAL<br/>PRINCIPAL<br/>AMOUNT</u> | <u>CONVERTED<br/>TO<br/>STOCK</u> | <u>PRINCIPAL<br/>BALANCE<br/>9/30/08</u> | <u>NUMBER OF<br/>WARRANTS<br/>ISSUED</u> | <u>WARRANT<br/>EXERCISE<br/>PRICE</u> |
|--|--|-----------------------------------|--|--|---------------------------------------|
| July 2005                              | \$1,250,000                              | \$1,250,000                       | \$ -                                     | 1,153,846                                | \$0.15                                |
| August 2005                            | 1,000,000                                | 1,000,000                         | -  | 923,077                                  | \$0.15                                |
| January 2006                           | 500,000                                  | 427,212                           | 72,788                                   | 961,539                                  | \$0.15                                |
| February 2006                          | 500,000                                  | -                                 | 500,000                                  | 461,539                                  | \$0.15                                |
| July 2006                              | 500,000                                  | 3,068                             | 496,932                                  | 20,000,000                               | \$0.05                                |
| November 2006                          | 500,000                                  | -                                 | 500,000                                  | 20,000,000                               | \$0.04                                |
| January 2007                           | 500,000                                  | -                                 | 500,000                                  | 20,000,000                               | \$0.01                                |
| March 2007                             | 500,000                                  | 122,505                           | 377,495                                  | 20,000,000                               | \$0.01                                |
| June 2007                              | 335,000                                  | -                                 | 335,000                                  | 10,000,000                               | \$0.01                                |
| August 2007                            | 250,000                                  | -                                 | 250,000                                  | 20,000,000                               | \$0.0014                              |
| October 2007                           | 275,000                                  | -                                 | 275,000                                  | 15,000,000                               | \$0.004                               |
| December 2007                          | 200,000                                  |                                   | 200,000                                  | 15,000,000                               | \$0.001                               |
| March 2008                             | 310,000                                  | -                                 | 310,000                                  | 10,000,000                               | \$0.0001                              |
| July 2008                              | 210,000                                  | -                                 | 210,000                                  | 20,000,000                               | \$0.001                               |
| Totals                                 | \$6,830,000                              | \$2,802,785                       | 4,027,215                                | 173,500,001                              |                                       |
| Accrued interest<br>added to principal |  |                                   | 506,022                                  |  |                                       |
| Balance 9/30/08                        |  |                                   | \$4,533,237                              |  |                                       |

The Notes are convertible into common shares at the lesser of \$0.10 or 30% of the market price of the Company's common stock, as defined. The Company may prepay the Notes at 150% of the outstanding principal and accrued interest balance, if sufficient authorized shares are available to convert all of the outstanding principal and accrued interest. 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 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 features and the prepayment penalties of each of the Notes to be treated as embedded derivatives, to be recorded as a collective liability equal to the estimated fair value of the embedded derivatives. As of September 30, 2008 and December 31, 2007 the Notes were convertible into 11,147,296,302 and 6,450,658,596 common shares, respectively, and the conversion features had estimated fair values of \$15,572,704 and \$13,003,762, respectively. As of December 31, 2007, the Company did not have enough authorized shares to allow conversion of all of the outstanding debt into stock. Consequently, the prepayment option was not available and no value for the prepayment feature was included in the computation of the estimated fair value of the derivatives for December 31, 2007. As of September 30, 2008 the Company did have enough authorized shares to convert the debt. Consequently, the prepayment option was

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(UNAUDITED)

available and the estimated fair value of this feature was included in the computation of the estimated fair value of the derivative as of September 30, 2008.

In addition, all warrants and options that are exercisable during the period that the Notes are outstanding are required to be recorded as liabilities at their estimated fair value. At September 30, 2008 and December 31, 2007 warrants and options to acquire a total of 393,580,124 and 156,729,001 common shares, respectively, were outstanding and had estimated fair values of \$520,852 and \$231,224, respectively.

The Company estimates the fair value of the embedded conversion and prepayment options of the callable secured convertible debt in a single pricing model with an embedded weighted average calculation. The assumptions used are to (1) determine the number of shares it would take to convert the debt under the terms of the agreements as of the balance sheet date; (2) estimate the future rate of debt conversions by the investors based on recent conversion history; (3) estimate the debt balance at specified dates, using 6 month intervals, based on the conversion rate determined in step 2; (4) value each of the components, including the conversions and the prepayment balances determined in step 3, using the Black-Scholes option pricing model; and (5) compute the estimated fair value of the combined derivatives by taking a weighted average of the values of the debt derivative and the prepayment options for the estimated prepayment dates based on estimated probability of occurrence of each event. Volatility rates ranged from 95% to 151% and 90% to 115% for the nine months ended September 30, 2008 and 2007, respectively. Risk free interest rates ranged from 0.92% to 3.99% and 3.43% to 5.07% for the nine months ended September 30, 2008 and 2007,



respectively. Volatility is calculated each reporting period and the calculation involves matching data points of our common share market price to the length of the option period. Fluctuations in volatility between individual derivatives and between periods are primarily due to the length of the option period.

The Company estimates the fair value of warrants and options using the Black-Scholes option pricing model and assumes all warrants and options would be exercised on their respective expiration dates. Volatility and risk free interest rate ranges are included in the ranges listed above.

The following table is a summary of the transactions and adjustments that comprised the calculation of the estimated fair value of the derivatives from January 1, 2007 to September 30, 2008:

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 ITRONICS INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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|   | Convertible<br>Debt<br><u>Derivative</u> | Warrant<br>And Option<br><u>Liability</u> |
|---|--|---|
| Estimated fair value as of  |  |   |
| December 31, 2006   | \$ 4,876,175                             | \$ 380,083                                |
| Additional borrowing in 2007  | 2,060,000                                | -   |
| Accrued interest  | 134,554                                  | -   |
| Warrants issued for services and<br>expensed or capitalized in 2007     | -  | 7,337                                     |
| Debt conversions into common shares                                     | (1,021,367)                              | -   |
| Year to date adjustment to Estimated<br>Fair Value at December 31, 2007 | 6,954,400                                | (156,196)                                 |
| Estimated Fair Value at December 31, 2007                               | 13,003,762                               | 231,224                                   |
| Additional borrowing in 2008  | 520,000                                  | -   |

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|   |              |            |
|---|--------------|------------|
| Accrued interest  | 423,425      | -          |
| Options issued for services and expensed or capitalized in 2008       | -            | 322,193    |
| Debt conversions  | (515,034)    | -          |
| Year to date adjustment to Estimated Fair Value at September 30, 2008 | 2,140,551    | (32,565)   |
| Estimated Fair Value at Sept. 30, 2008                                | \$15,572,704 | \$ 520,852 |

The fair value of the beneficial conversion option, prepayment penalties, warrants and options are 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.

Following is a summary of the gains and (losses) on derivative instruments by reporting period for the three and nine months ended September 30, 2008 and 2007:

|                              | Three Months Ended Sept. 30, |             | Nine Months Ended Sept 30, |             |
|------------------------------|------------------------------|-------------|----------------------------|-------------|
|                              | <u>2008</u>                  | <u>2007</u> | <u>2008</u>                | <u>2007</u> |
| Convertible debt derivative  | \$(4,671,147)                | \$ 868,638  | \$(2,140,551)              | \$1,489,626 |
| Warrant and option liability | 46,949                       | 894,269     | 32,565                     | 104,528     |
|                              | \$(4,624,198)                | \$1,762,907 | \$(2,107,986)              | \$1,594,154 |

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From May 14, 2008 through September 30, 2008, the Noteholders converted a total of \$515,034 into 659,713,700 common shares. During 2007 the Noteholders converted a total of \$1,021,367 of the Notes into 546,758,396 common shares.

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On October 10, 2008, the Company received a Notice of Default from AJW Partners, LLC, New Millenium Capital Partners II, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and AJW Master Fund, Ltd. (collectively, the "plaintiffs"), claiming that the Company was purportedly in default of certain obligations under the Company's notes issued to the plaintiffs. On October 16, 2008 the plaintiffs filed suit against the Company and its subsidiaries in the Supreme Court of the State of New York alleging a breach of contract and other claims concerning certain agreements the Company has with those parties. The suit seeks in excess of \$5,000,000. The Company plans to vigorously defend these allegations and assert various counter-claims that it has against those plaintiffs.

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.As of September 30, 2008 we have accrued for liabilities, including interest, of \$561,972 which relate to various lawsuits and claims for the collection of the funds due. These include 8 leases totaling \$366,025 (reflected in Capital Lease Obligations) plus \$73,835 in additional interest (reflected in Accrued Interest) and one trade payable totaling \$85,801 (reflected in Accounts Payable) plus \$36,311 in additional interest (reflected in Accrued Interest). The leases are individually secured by specified equipment.

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

The Company has two cases, that originally sought \$171,853, that we deem to have a remote possibility of incurring an additional unrecorded loss. The Company has negotiated payment agreements on these cases and, as of September 30, 2008, the recorded liability for these cases was \$162,795. We are delinquent in our payments under the respective settlement agreements, but are in contact with counsel for the creditor, and no collection action has been taken.

In addition to the above leases that are subject to litigation, there are two leases, with a recorded liability of \$107,007, that are in default. As required by U.S. Generally Accepted Accounting Principles, the principal balance of the leases that are in default have been classified as current liabilities.

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

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### ITRONICS INC. AND SUBSIDIARIES

#### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

5. In the first quarter of 2006 all of the Series 2000 Convertible Promissory Notes became due and were in default. The total principal and interest due at September 30, 2008 is \$3,816,135. In September 2008 the Company began a plan to extend the Notes for four years and a day by offering to pay the principal and accrued interest with common stock in 17 quarterly installments. The stock is priced at the greater of the average of the five closing bids prior to the payment date or \$0.0015 per share. In addition, the interest rate is reduced from 12% to 6% and Noteholders agreeing to the extension receive one year warrants to acquire 100,000 shares of common stock per \$1,000 of original principal amount at an exercise price of \$0.005 per share. If all the Noteholders agree to the extension, warrants to acquire a total of 143,700,000 common shares will be issued.

As of September 30, 2008 Noteholders holding a total of \$444,299 in principal and accrued interest extended their Notes and warrants to acquire 18,000,000 common shares were issued. The estimated fair value of these warrants is included in the estimated fair value of warrants and options described in Note 3 above and were valued with the same methodology as the other warrants and options. Subsequent to September 30, 2008, principal and accrued interest totaling \$788,060 were extended and warrants to acquire 32,000,000 common shares were issued. The Notes that have not been extended remain in default, but no collection action has been taken.

As the number of shares required to repay our Callable Secured Convertible Notes is potentially unlimited, the extended Series 2000 Convertible Notes must be accounted for under SFAS 133 and EITF 00-19. The estimated fair value was determined using the Black-Scholes option pricing model. Volatility and risk free interest rate ranges are included in Note 3 above. Based on the average closing bids for the five days prior to September 30, 2008, the extended Notes would be convertible into 267,650,000 common shares. The estimated fair value of the conversion option of the extended Notes is \$153,462. Since this amount is less than the face amount of the extended Notes, no gain or loss on derivatives was reported.

The Company's mortgage loan on the manufacturing facility is in default due to delinquent property taxes totaling \$18,661. The lender is aware of the

ITRONICS INC. AND SUBSIDIARIES

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situation and has taken no collection action. As a result of the default, the entire principal balance, in the amount of \$398,434, is included in current liabilities. In addition, the Company's semi-annual payment on a City of Reno Special Assessment District loan in the amount of \$4,284 is delinquent. As a result, the entire principal balance in the amount of \$83,962 is included in current liabilities.

As of September 30, 2008 the Company owed \$88,669 for federal payroll taxes. \$12,046 of this amount was paid subsequent to September 30, 2008. The Company is in contact with the IRS and believes a payment arrangement can be made for the remaining balance due. The IRS has filed federal tax liens and may seize Company assets if

satisfactory arrangements cannot be made.

6. Following is a summary of finished goods, work in progress, and raw materials inventories as of September 30, 2008 and December 31, 2007. The raw material and work in progress balances below include \$785,414 and \$640,484 in silver bearing unprocessed photochemicals or partially processed materials as of September 30, 2008 and December 31, 2007, respectively.

|   | Sept. 30,<br><u>2008</u> | Dec. 31,<br><u>2007</u> |
|---|--------------------------|-------------------------|
| Finished goods  | \$ 54,772                | \$ 46,211               |
| Work in progress  | 652,919                  | 522,273                 |
| Raw materials   | 461,446                  | 425,673                 |
|   | 1,169,137                | 994,157                 |
| Less: Silver recoverability<br>and slow moving reserves | 104,161                  | 104,161                 |
| Net Inventory   | \$1,064,976              | \$889,996               |

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, 2007 through September 30, 2008:

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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|                 | Convertible         | Employee       |              |
|-----------------|---------------------|----------------|--------------|
| <u>Warrants</u> | <u>Debt Options</u> | <u>Options</u> | <u>Total</u> |

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|                                 |             |                |             |                |
|---------------------------------|-------------|----------------|-------------|----------------|
| Under option, December 31, 2006 | 58,599,501  | 586,181,548    | 6,322,000   | 651,103,049    |
| Granted                         | 100,000,000 | 6,411,235,444  | 252,000     | 6,511,487,444  |
| Exercised                       | -           | (546,758,396)  | -           | (546,758,396)  |
| Expired/Adjusted                | (8,134,500) | -              | (310,000)   | (8,444,500)    |
| Under option, December 31, 2007 | 150,465,001 | 6,450,658,596  | 6,264,000   | 6,607,387,597  |
| Granted                         | 48,000,000  | 5,624,001,406  | 194,836,123 | 5,866,837,529  |
| Exercised                       | -           | (659,713,700)  | -           | (659,713,700)  |
| Expired/Adjusted                | (5,725,000) | -              | (260,000)   | (5,985,000)    |
| Under option, Sept. 30, 2008    | 192,740,001 | 11,414,946,302 | 200,840,123 | 11,808,526,426 |

The average price for all warrants and options granted and exercised was \$0.0006 for the nine months ended September 30, 2008 and \$0.0009 for the year ended December 31, 2007.

The following table summarizes the warrants and options outstanding as of September 30, 2008:

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ITRONICS INC. AND SUBSIDIARIES

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| <u>Expiration Dates</u>    | <u>No. of<br/>Shares</u> | <u>Exercise<br/>Price</u> | <u>Weighted<br/>Average<br/>Exercise<br/>Price</u> |
|----------------------------|--------------------------|---------------------------|--|
| <u>Warrants:</u>           |                          |                           |  |
| March 2015                 | 10,000,000               | \$0.0001                  |  |
| December 2014 to July 2015 | 35,000,000               | 0.001                     |  |

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|                                  |                |           |          |
|----------------------------------|----------------|-----------|----------|
| August 2014                      | 20,000,000     | 0.0014    |          |
| October 2014                     | 15,000,000     | 0.004     |          |
| September 2009                   | 18,000,000     | 0.005     |          |
| January to June 2014             | 50,000,000     | 0.010     |          |
| November 2013                    | 20,000,000     | 0.040     |          |
| July 2013                        | 20,000,000     | 0.050     |          |
| March 2010                       | 1,000,000      | 0.100     |          |
| July 2010 to February 2011       | 3,740,001      | 0.150     |          |
| Total Warrants                   | 192,740,001    |           | \$0.0165 |
| <u>Convertible Debt Options:</u> |                |           |          |
| August 2008 to July 2011         | 11,147,296,302 | \$0.00043 |          |
| October 2012                     | 267,650,000    | .00166    |          |
| Total Convertible Debt options   | 11,414,946,302 |           | \$0.0005 |
| <u>Employee Options:</u>         |                |           |          |
| September 2018                   | 194,694,123    | \$0.002   |          |
| August 2008 to February 2018     | 424,000        | 0.150     |          |
| One year after employment ends   | 1,450,000      | 0.150     |          |
| May 2017 to May 2018             | 80,000         | 0.160     |          |
| January 2015 to January 2018     | 175,000        | 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           | 200,840,123    |           | \$0.0093 |
| Total Warrants and Options       | 11,808,526,426 |           | \$0.0009 |

The 11,147,296,302 convertible debt options listed above relate to the callable secured convertible debt discussed in Note 3 above. As of September 30, 2008 \$4,793,337 of principal and accrued interest was convertible into common stock at the lower of \$0.10 per share or 30% of a calculated market price. The 267,650,000 convertible debt options listed above relate to the Series 2000 Convertible Notes discussed in Note 5 above. As of September 30, 2008 \$444,299 of principal and interest will be paid in common stock in 17 quarterly installments. The stock price is based on the greater of the average of the five closing bid prices prior to the date of payment or \$0.0015 per

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 ITRONICS INC. AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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share. Consequently, the number of shares and the conversion prices for both these categories of debt can vary up or down materially, depending on the Company's stock price at any point in time.

## 8. Earnings (Loss) per Common Share:

Basic Earnings (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 the three and nine months ended September 30, 2008 and 2007.

Diluted Earnings (loss) per common share assumes that any dilutive convertible debt outstanding and stock options and warrants were converted on the first day of the period. Interest expense (net of tax) incurred during the period that is related to convertible debt is added back to net income for purposes of the computation. Any stock options or warrants with exercise prices below the weighted average market price for the quarter are excluded from the computation. For purposes of computing diluted earnings per common 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 basic and diluted earnings (loss) per common share (EPS) for the three and nine months ended September 30, 2008 and 2007.

|                                 | Three months Ended Sept 30, |             | Nine months Ended Sept 30, |               |
|---------------------------------|-----------------------------|-------------|----------------------------|---------------|
|                                 | <u>2008</u>                 | <u>2007</u> | <u>2008</u>                | <u>2007</u>   |
| Net Income (Loss)               | \$(5,957,269)               | \$ 544,325  | \$(4,763,275)              | \$(1,159,645) |
| Less: Preferred stock dividends | -                           | -           | -                          | -             |
|                                 | (5,957,269)                 | 544,325     | (4,763,275)                | (1,159,645)   |



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|   |               |            |               |               |
|---|---------------|------------|---------------|---------------|
| Basic EPS income (loss) available<br>to common stockholders   |               |            |               |               |
| Interest on convertible securities,<br>net of tax             | -             | 75,464     | -             | -             |
| Diluted EPS income (loss) available<br>to common shareholders | \$(5,957,269) | \$ 619,789 | \$(4,763,275) | \$(1,159,645) |
| Weighted average number of shares<br>outstanding (1,000 s)    | 1,560,397     | 466,067    | 1,211,448     | 407,278       |
| Common equivalent shares (1,000 s)                            | N/A           | 2,287,909  | N/A           | N/A           |
| Diluted average number of shares<br>outstanding (1,000 s)     | 1,560,397     | 2,753,976  | 1,211,448     | 407,278       |
| Per share amount -basic                                       | \$(0.004)     | \$0.001    | \$(0.004)     | \$(0.003)     |
| Per share amount- diluted                                     | \$(0.004)     | \$0.0002   | \$(0.004)     | \$(0.003)     |

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ITRONICS INC. AND SUBSIDIARIES

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Warrants, options, and shares to be issued, totaling 12,124,946,764 shares as of September 30, 2008 would dilute EPS, and accordingly are not included in the computation of EPS for the three and nine months ended September 30, 2008. Warrants, options, and shares to be issued, totaling 2,424,844,738 shares as of September 30, 2007, would dilute EPS, and accordingly are not included in the computation of EPS for the nine months ended September 30, 2007.

9. The Company adopted the provisions of SFAS 123R, *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 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 123R 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 123R. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

Total estimated share-based compensation expense recognized under SFAS 123R for the three months ended September 30, 2008 and 2007 was \$345,690 and \$11,436, respectively. Total estimated share-based compensation expense recognized under SFAS 123R for the nine months ended September 30, 2008 and 2007 was \$333,216 and \$13,161, respectively.

In addition to a stock option program for employees, certain employees, directors and various consultants receive the majority of their compensation in common shares. Shares issued for consulting services include such services as transportation, contracting, and corporate marketing and investor relations programs. Shares issued to employees, directors, and consultants are valued at the closing market price of our common stock on the transaction date. Total expenses paid in common stock for employees, directors, and consultants was \$193,649 and \$579,150 for the nine months ended September 30, 2008 and 2007, respectively. These expenses are allocated between the two segments and between expense categories in the Consolidated Statements of Operations based on the type of service provided.

10. Following is financial information for each of the Company's segments. No changes have occurred in the basis of segmentation since December 31, 2007.

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,

2008

2007

2008

2007

Revenues:

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|                                 |                |              |               |               |
|---------------------------------|----------------|--------------|---------------|---------------|
| GOLD n GRO Fertilizer           | \$ 472,124     | \$ 533,624   | \$ 2,301,903  | \$ 1,901,436  |
| Mining Technical Services       | 21,784         | 8,329        | 108,999       | 14,957        |
| Consolidated Revenues           | \$ 493,908     | \$ 541,953   | \$ 2,410,902  | \$ 1,916,393  |
| Gross Profit (Loss):            |                |              |               |               |
| GOLD n GRO Fertilizer           | \$ (6,637)     | \$ 17,333    | \$ 383,431    | \$ 150,405    |
| Mining Technical Services       | 2,031          | (1,909)      | 37,328        | (11,011)      |
| Consolidated Gross Profit       |                |              |               |               |
| <b>(Loss)</b>                   | \$ (4,606)     | \$ 15,424    | \$ 420,759    | \$ 139,394    |
| Operating Income (Loss):        |                |              |               |               |
| GOLD n GRO Fertilizer           | \$ (732,989)   | \$ (671,486) | \$(1,207,999) | \$(1,602,101) |
| Mining Technical Services       | (141,184)      | (203,784)    | (401,504)     | (569,120)     |
| Consolidated Operating          |                |              |               |               |
| <b>Income (Loss)</b>            | \$ (874,173)   | \$ (875,270) | \$(1,609,503) | \$(2,171,221) |
| Other Income (Expense):         |                |              |               |               |
| GOLD n GRO Fertilizer           | \$ (5,083,096) | \$ 1,423,419 | \$(3,153,772) | \$ 868,858    |
| Mining Technical Services       | -              | (3,824)      | -             | 142,718       |
| Consolidated Other Income       |                |              |               |               |
| <b>(Expense)</b>                | \$ (5,083,096) | \$ 1,419,595 | \$(3,153,772) | \$1,011,576   |
| Net Income (Loss) before taxes: |                |              |               |               |
| GOLD n GRO Fertilizer           | \$(5,816,085)  | \$ 751,933   | \$(4,361,771) | \$(733,243)   |
| Mining Technical Services       | (141,184)      | (207,608)    | (401,504)     | (426,402)     |

Consolidated Net Income

|                     |                |            |                |                |
|---------------------|----------------|------------|----------------|----------------|
| (Loss) before taxes | \$ (5,957,269) | \$ 544,325 | \$ (4,763,275) | \$ (1,159,645) |
|---------------------|----------------|------------|----------------|----------------|

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ITRONICS INC. AND SUBSIDIARIES

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

|                              | September 30,<br><u>2008</u> | December 31,<br><u>2007</u> |
|------------------------------|------------------------------|-----------------------------|
| Current Assets:              |                              |                             |
| GOLD n GRO Fertilizer        | \$1,170,650                  | \$ 1,033,487                |
| Mining Technical Services    | 25,225                       | 15,743                      |
|                              | 1,195,875                    | 1,049,230                   |
| Property and Equipment, net: |                              |                             |
| GOLD n GRO Fertilizer        | 2,659,843                    | 2,769,179                   |
| Mining Technical Services    | 72,552                       | 83,143                      |
|                              | 2,732,395                    | 2,852,322                   |
| Other Assets, net:           |                              |                             |
| GOLD n GRO Fertilizer        | 104,552                      | 108,318                     |

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|                                 |              |              |
|---------------------------------|--------------|--------------|
| Mining Technical Services       | 3,483        | 3,483        |
|                                 | 108,035      | 111,801      |
| Total Assets:                   |              |              |
| GOLD n GRO Fertilizer           | 3,935,045    | 3,910,984    |
| Mining Technical Services       | 101,260      | 102,369      |
| Total Segment Assets            | 4,036,305    | 4,013,353    |
| Itronics Inc. assets            | 29,666,753   | 28,787,327   |
| Less: inter-company elimination | (29,409,750) | (28,444,812) |
| Consolidated Assets             | \$4,293,308  | \$4,355,868  |

11. The Company periodically holds marketable securities that are available for sale, which have consisted solely of equity securities. The carrying amount on the balance sheets of these securities is adjusted to market value at each balance sheet date. The adjustment to market 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, 2008 and December 31, 2007. No gains or losses were reclassified out of accumulated other comprehensive income into earnings during the three and nine months ended September 30, 2008. No losses were reclassified out of accumulated other comprehensive income into earnings during the three and nine months ended September 30, 2007. The table below illustrates the amount of

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2008

(UNAUDITED)

unrealized holding gains and losses included in other comprehensive income, net of tax effects of \$0. The reclassification adjustment, if any, listed in the below table represents unrealized holding gains and losses transferred into earnings as securities are sold.

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Following are the components of Other Comprehensive Income:

|                                      | <u>Three Months Ended Sept 30,</u> |             | <u>Nine Months Ended Sept 30,</u> |             |
|--------------------------------------|------------------------------------|-------------|-----------------------------------|-------------|
|                                      | <u>2008</u>                        | <u>2007</u> | <u>2008</u>                       | <u>2007</u> |
| Unrealized holding gains<br>(losses) |                                    |             |                                   |             |
| arising during the period            | \$ -                               | \$ -        | \$ -                              | \$ 2,246    |
| Reclassification adjustment          | -                                  | (3,115)     | -                                 | (2,246)     |
| Other Comprehensive Income<br>(Loss) | \$ -                               | \$(3,115)   | \$ -                              | \$ -        |

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>2008</u>        | <u>2007</u> | <u>2008</u>       | <u>2007</u> |
| Gross proceeds from sale of securities        | \$ -               | \$ 35,870   | \$ -              | \$142,088   |
| Gross gains from sale of securities           | \$ -               | \$ -        | \$ -              | \$ 7,718    |
| Gross losses from sale of securities          | -                  | (3,983)     | -                 | (3,983)     |
| Net Gains (Losses) from sale of<br>Securities | \$ -               | \$(3,983)   | \$ -              | \$3,735     |

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.Fair value of financial instruments

On January 1, 2008, the Company adopted SFAS 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosures requirements for fair value measures. The carrying amounts reported in the balance sheets for receivables, payables, and short term debt that qualify as financial instruments are a reasonable estimate of fair value because of the short period of time between the origination of such instruments and their expected realization and their current market rate

of interest. The carrying amounts reported in the balance sheets for long term debt obligations with no equity component that qualify as financial instruments are a reasonable estimate of fair value as the instruments have current market interest rates. The three levels are defined as follow:

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ITRONICS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(UNAUDITED)

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are

observable for the assets or liability, either directly or indirectly, for substantially the full term of the financial instruments.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value.

The Company analyzes all financial instruments with features of both liabilities and equity under SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," SFAS No 133, "Accounting for Derivative Instruments and Hedging Activities" and EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."

The Company's Series 2000 convertible debt derivatives are carried at fair value totaling \$153,462 and \$-0- as of September 30, 2008 and December 31, 2007, respectively. The Company's callable secured convertible debt derivatives are carried at fair value totaling \$15,572,704 and \$13,003,762, as of September 30, 2008 and December 31, 2007, respectively. The Company carries its warrant and option liability at fair value totaling \$520,852 and \$231,224 as of September 30, 2008 and December 31, 2007, respectively. The Company used Level 2 inputs for its valuation methodology for the Series 2000 convertible debt derivatives, the callable secured convertible debt derivatives, and the warrant and option liability.

Fair Value As  
of

Sept 30, 2008

Fair Value Measurements at Sept. 30, 2008 Using Fair  
Value Hierarchy

| <u>Liabilities</u>                            |    | Level 1    | Level 2      | Level 3 |
|---|----|------------|--------------|---------|
| Series 2000 convertible debt derivatives      | \$ | 153,462    | \$ 153,462   |         |
| Callable secured convertible debt derivatives | \$ | 15,572,504 | \$15,572,504 |         |
| Warrant and option liability                  | \$ | 520,852    | \$ 520,852   |         |

The Company recognized gains (losses) of the respective components of the derivative instruments of \$-0-, \$(2,140,551) and \$32,565, respectively, for the nine months ended September 30, 2008.

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## ITRONICS INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2008

(UNAUDITED)

The Company did not identify any other non-recurring assets and liabilities that are required to be presented on the balance sheet at fair value in accordance with SFAS No. 157. The Company also adopted SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities" on January 1, 2008. SFAS 159 permits entities to choose to measure certain financial and non-financial items at fair value that are not otherwise required to be measured at fair value. The Company chose not to elect the option to measure eligible items at fair value.

#### 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 \$493,908 for the quarter ended September 30, 2008, compared to \$541,953 for the prior year quarter, a decrease of 9%. The decrease was primarily due to prior year Photochemical Silver Concentrator sales of \$164,500. A similar amount of sales will be reported in the fourth quarter of 2008. Excluding those sales from prior year amounts results in an increase of \$116,500, or 31% in total sales. Consolidated net loss was \$5,957,269, or \$0.004 per share, for the quarter ended September 30, 2008, compared to net income of \$544,325 or \$0.001 per share for the comparable 2007 period, an increased loss of \$6,501,600. The significant change from a profit to a loss is due to a loss on derivatives of \$4,624,200 compared to a gain of \$1,762,900 for the prior year quarter.

Consolidated revenues for the first nine months of 2008 were \$2,410,902 compared to \$1,916,393 for the prior year period, an increase of 26%. Excluding the Photochemical Silver Concentrator sales from the prior year amount results in an increase of 38%. Consolidated net loss was \$4,763,275, or \$0.004 per share, for the nine months ended September 30, 2008, compared to a net loss of \$1,159,645 or \$0.003 per share for the comparable 2007 period, an increased loss of

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\$3,603,600. The increased loss is due to a loss on derivatives of \$2,108,000 compared to a gain of \$1,594,200 for the prior year period.

To provide a more complete understanding of the factors contributing to the changes in revenues, operating expenses, other income (expense) and the resulting 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<br>Sept 30, |             | Nine Months Ended Sept 30, |              |
|------------------------|--------------------------------|-------------|----------------------------|--------------|
|                        | <u>2008</u>                    | <u>2007</u> | <u>2008</u>                | <u>2007</u>  |
| Revenues               |                                |             |                            |              |
| Fertilizer             | \$ 360,288                     | \$ 239,965  | \$ 1,920,731               | \$ 1,398,902 |
| Photochemical services | \$ 40,911                      | \$ 206,265  | \$ 112,229                 | \$ 294,243   |
| Silver                 | \$ 70,925                      | \$ 87,394   | \$ 268,943                 | \$ 208,291   |
| Total Revenue          | \$ 472,124                     | \$ 533,624  | \$ 2,301,903               | \$ 1,901,436 |
| Gross profit (loss)    | \$ (6,637)                     | \$ 17,333   | \$ 383,431                 | \$ 150,405   |

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|                                |               |             |               |               |
|--------------------------------|---------------|-------------|---------------|---------------|
| Operating income (loss)        | \$ (732,989)  | \$(671,486) | \$(1,207,999) | \$(1,602,101) |
| Other income (loss)            | \$(5,083,096) | \$1,423,419 | \$(3,153,772) | \$ 868,858    |
| Net income (loss) before taxes | \$(5,816,085) | \$ 751,933  | \$(4,361,771) | \$(733,243)   |

Total segment revenues for the third quarter of 2008 were approximately \$472,100, a decrease of 12% from the third quarter of 2007. Total fertilizer sales for the quarter were \$360,300 (315 tons), compared to \$240,000 (317 tons) for the 2007 third quarter, an increase of 50% in dollars and a nominal decrease in tonnage. Sales of bulk Chelated Liquid Micro-nutrients were \$296,800 (237 tons) and \$185,000 (200 tons) for the third quarter of 2008 and 2007, respectively, an increase of 60% in dollars and 18% in tonnage. Sales of bulk Chelated Liquid Multi-nutrients were \$42,000 (70 tons) and \$49,000 (115 tons) for the third quarter of 2008 and 2007, respectively, a decrease of 14% in dollars and 40% in tonnage. A new Chelated Secondary Nutrient product was introduced in the second quarter of 2006. Sales of this product were \$16,000 (8 tons) and \$1,900(1 tons) for the third quarter of 2008 and 2007, respectively, an increase of 742% in dollars and 500% in tonnage. The overall increase in sales was due to price increases. Total photochemical services revenue for the quarter decreased \$165,400 due primarily to prior year Photochemical Silver Concentrator sales totaling \$164,500. A similar sale was completed early in the fourth quarter of 2008. Excluding those sales, photochemical service revenue declined nominally on a 6% increase in volume. Silver sales were \$70,900 (4,972 ounces) for the quarter, compared to \$87,400 (6,337 ounces) for the prior year third quarter, a decrease of 19% in dollars and 22% in ounces. The decrease is attributable to a decline in ounces sold of both silver bullion and film.

Cost of sales decreased \$37,500 due primarily to a decline of \$109,000 in raw materials costs resulting from prior year Photochemical Silver Concentrator sales. This decrease was partially offset by increases of \$45,600 in fertilizer raw materials costs resulting from increased sales and payroll costs of \$13,200. The segment recorded a gross loss of \$6,600 for the quarter, compared to a gross profit of \$17,300 for the third quarter of 2007, a decreased gross profit of \$24,000. Excluding the gross profit of \$55,500 resulting from the prior year Photochemical Silver Concentrator sales, gross profit for the third quarter of 2008 would be improved by \$31,500, or 83%.

We are continuing our efforts on sales of Photochemical Silver Concentrators in order to provide a long term base of used photochemical supply. In March 2007 we received a deposit on a

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Photochemical Silver Concentrator and it was delivered in July 2007. During the second quarter of 2008 we received another order from the same customer. Delivery was made early in the fourth quarter. Between August 2006 and April 2007, we obtained three new significant wholesale customers. In April and October 2008 we obtained two additional significant wholesale customers. As a result of these new customers, we expect the rate of growth in sales volume will be significantly greater than the rate of growth in sales dollars.

We anticipate that the new customers, along with our existing suppliers, will provide sufficient raw material for fertilizer production for the 2009 fertilizer season and future years. We expect raw material needs to be met well into the future because these customers have national collection services and we believe we will be able to expand supply of photo liquids as fertilizer demand grows.

Segment operating expenses increased \$37,500 from the third quarter of 2007. This was due to \$321,500 in stock option compensation related to a one time option grant to members of management to compensate them for their unpaid salary and cash loans. This increase was partially offset by decreases of \$219,200 in sales and marketing expenses related primarily to decreased corporate marketing and \$67,000 in general and administration costs due

primarily to reduced outside consulting services.

These factors resulted in a 2008 third quarter segment operating loss of \$733,000 compared to a loss of \$671,500 for the third quarter of 2007, an increased operating loss of \$61,500, or 9%. Excluding the non-recurring, non-cash option compensation expense of \$321,500, the operating loss would be \$411,500, which would be an improvement of \$260,000 or 39%.

Other income (expense) was an expense of \$5,083,100 for the quarter, compared to other income of \$1,423,400 for the 2007 third quarter, an increased expense of \$6,506,500. The increase in other (expense) is due primarily to a swing in gain (loss) on derivative instruments from a gain of \$1,762,900 in the prior year third quarter to a loss of \$4,624,200 in the current third quarter, an increased loss of \$6,387,100. The gain or loss on derivatives is related to our callable secured convertible debt, 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 income (expense) resulted in a segment net loss before taxes of \$5,816,100 for the quarter ended September 30, 2008, compared to segment net income before taxes of \$751,900 for the prior year quarter, an increased loss of \$6,568,000.

For the first nine months of 2008, segment revenues were \$2,301,900, compared to \$1,901,400 for the comparable 2007 period, an increase of 21%. The increase is due to increases in fertilizer and silver revenues. Gross profit for the first nine months of 2008 was \$383,400, compared to \$150,400 for the comparable prior year period, an improvement of 155%. Operating loss for the first nine months of 2008 was approximately \$1,208,000 compared to \$1,602,100 for the first nine months of 2007, a reduced operating loss of \$394,100, or 25%. Excluding the non-recurring, non-cash option compensation expense of \$321,500, the operating loss would be \$886,500, which would be an improvement of \$715,600 or 45%.

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Other income (expense) was an expense of \$3,153,800 for the first nine months of 2008, compared to other income of \$868,900 for the comparable 2007 period, an increased loss of \$4,022,600. The decline is primarily due to a change from a gain to a loss on derivative instruments totaling \$3,702,100. The gain or loss on derivatives is related to our callable secured convertible debt, 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 \$4,361,800 for the nine months ended September 30, 2008, compared to segment net loss before taxes of \$733,200 for the prior year period, an increased loss of \$3,628,500.

#### MINING TECHNICAL SERVICES

|                         | Three Months Ended<br>Sept 30, |             | Nine Months Ended Sept 30, |             |
|-------------------------|--------------------------------|-------------|----------------------------|-------------|
|                         | <u>2008</u>                    | <u>2007</u> | <u>2008</u>                | <u>2007</u> |
| Revenues                | \$ 21,784                      | \$ 8,329    | \$ 108,999                 | \$ 14,957   |
| Gross profit (loss)     | \$ 2,031                       | \$ (1,909)  | \$ 37,328                  | \$ (11,011) |
| Operating income (loss) | \$(141,184)                    | \$(203,784) | \$(401,504)                | \$(569,120) |

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|                                   |             |             |             |             |
|-----------------------------------|-------------|-------------|-------------|-------------|
| Other income (expense)            | -           | \$ (3,824)  | -           | \$ 142,718  |
| Net income (loss)<br>before taxes | \$(141,184) | \$(207,608) | \$(401,504) | \$(426,402) |

Mining technical services revenue was \$21,800 for the quarter ended September 30, 2008, compared to \$8,300 for the comparable quarter of 2007, an increase of 162%. The increase came from one technical services project during the quarter. Cost of sales increased \$9,500, due to an increase in pass-through costs, which were related to the technical services project discussed above. These factors resulted in a third quarter gross profit for the segment of \$2,000 compared to a gross loss of \$1,900 for the prior year third quarter, an improvement of \$3,900.

The Whitney & Whitney, Inc. reduced emphasis on technical consulting services and launch of 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 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, 2008 and 2007 we allocated costs of approximately \$48,400 and \$60,900, respectively, to the development of the web site. The site was launched in mid-August 2005 and we are now expanding the content of the site, as well as improving the profiled mining company information. We expect this level of spending to continue into at least the fourth quarter of 2008. As improvements to the site are completed and information maintenance becomes routine, we will reduce or redirect staff resources as needed. A program to solicit advertising customers was developed and is being offered to gold exploration companies beginning in the first quarter of 2007. We are presently evaluating the steps we need to take to improve the revenue growth from the website.

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Total segment operating expenses for the third quarter of 2008 decreased \$58,700, due primarily to decreased sales and marketing costs related to corporate marketing and to the insidemetals.com website discussed above and to decreased research and development costs related to the insidemetals.com website.

The combination of these factors resulted in a 2008 third quarter segment operating loss of \$141,200, compared to an operating loss of \$203,800 for the third quarter of 2007, a decreased operating loss of \$62,600, or 31%.

Other income (expense) for the third quarter of 2008 was \$-0- compared to a loss of \$3,800 for the prior year third quarter. The prior year loss was from the sale of stock received in an exchange of our membership interest in our workers compensation insurance carrier.

The changes in operating loss and other income resulted in a segment net loss before taxes of \$141,200 for the quarter ended September 30, 2008, compared to a loss of \$207,600 for the prior year quarter, a decreased loss of \$66,400, or 32%.

For the first nine months of 2008, segment revenue totaled \$109,000 compared to \$15,000 for the first nine months of 2007, an increase of 629%. This is primarily attributable to new technical services projects. Gross profit for the first nine months of 2008 was \$37,300, compared to a gross loss of \$11,000 for the comparable prior year period, an

improvement of \$48,300. Operating loss for the period was \$401,500 compared to an operating loss of \$569,100 for the comparable 2007 period, a decreased operating loss of \$167,600, or 29%.

Other income (loss) for the first nine months of 2008 was \$-0- compared to a gain of \$142,700 for the prior year period. The prior year gain was due to the sale of a membership interest in the Company's worker's compensation mutual insurance company.

The changes in operating loss and other income resulted in a segment net loss before taxes of \$401,500 for the nine months ended September 30, 2008, compared to a net loss of \$426,400 for the prior year period, a decreased loss of \$24,900, or 6%.

## SUMMARY

On a consolidated basis, the various changes in revenues and operating expenses resulted in a third quarter 2008 operating loss of \$874,200, compared to \$875,300 for the third quarter of 2007, a nominal decreased operating loss. Excluding the non-recurring, non-cash option compensation expense of \$321,500, the operating loss would be \$552,700, which would be an improvement of \$322,600 or 37%. Net income (loss) before taxes for the third quarter 2008 was a loss of \$5,957,300 compared to a net income before taxes of \$544,300 for the prior year third quarter, an increased loss of \$6,501,600. The decrease is primarily due to a change from a gain to a loss on derivatives totaling \$6,387,100. For the nine month period ended September 30, 2008 consolidated operating loss was \$1,609,500 compared to \$2,171,200 for the prior year comparable period, a decreased operating loss of \$561,700, or 26%. Excluding the non-recurring, non-cash option compensation expense of \$321,500, the operating loss would be \$1,288,000, which would be an improvement of \$883,200 or 41%. Net income (loss) before taxes for the nine months

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ended September 30, 2008 was a net loss of \$4,763,300 compared to a net loss before taxes of \$1,159,600 for the prior year nine month period, an increased loss of \$3,603,600.

## Changes in Financial Condition; Capitalization

Cash amounted to \$-0- as of September 30, 2008, compared to \$20,300 as of September 30, 2007. Net cash used for operating activities was approximately \$691,100 for the first nine months of 2008. The cash used for operating activities during the period was financed by net proceeds of \$500,000 from the issuance of callable secured convertible notes, less \$43,800 in debt issuance costs, proceeds from the sale of stock of \$95,000, loans totaling \$64,000 from officer/stockholders, and increases in current liabilities of \$148,900 in accounts payable, \$224,000 in management salaries, \$169,300 in accrued expenses, and \$189,000 in accrued interest.

Total assets decreased \$62,600 during the nine months ended September 30, 2008 to \$4,293,300. Current assets increased \$139,900 due to increases in accounts receivable of \$35,100 and inventory of \$175,000. These increases were partially offset by a decrease in cash of \$93,000. Inventory increased primarily due to the accumulation of silver contained in photographic wastes received from our customers. Net property and equipment decreased \$119,900 due to current period depreciation and amortization. Other assets decreased \$82,500 due to amortization of deferred loan fees related to the callable secured convertible note financing.

Current liabilities increased during the nine months ended September 30, 2008 by \$3,091,400 and total liabilities increased by \$3,338,300. The increase is primarily due to an increase of \$2,568,900 in the estimated fair value of derivative instruments. The major components of this increase include \$520,000 in new convertible debt borrowing, \$423,400 in accrued interest, conversions to common stock of \$515,000 and a net increase in estimated fair value of

derivative instruments of \$2,140,600. The increase in estimated fair value of the derivative instruments is primarily due to a decreased stock conversion price at September 30, 2008 compared to December 31, 2007. The current stock price used in the Black-Scholes model used to compute estimated fair value was \$0.0018 at September 30, 2008 and \$0.0026 at December 31, 2007. The conversion price used in the same computation was \$0.0004 and \$0.0007 for September 30, 2008 and December 31, 2007, respectively. The decreased stock conversion price resulted in an increase in the number of shares needed to convert the callable secured convertible debt from 6,450,658,596 common shares at December 31, 2007 to 11,147,296,302 common shares at September 30, 2008.

Other changes in current liabilities include increases of, \$144,700 in accounts payable, \$71,900 in accrued expenses, \$155,300 in interest payable to officer/stockholders, \$60,500 in current maturities of long-term debt, and \$81,100 in other liabilities. These increases were partially offset by decreases of \$216,000 in accrued management salaries and \$79,300 in current maturities of capital lease obligations. Accrued management salaries decreased due to the conversion of \$440,000 of unpaid salary into common stock to be issued when sufficient cash is available to pay the associated payroll taxes.

Long term liabilities increased by \$246,900 due primarily to the reclassification out of current liabilities of \$329,100 in Series 2000 convertible notes that was extended as discussed in Note 5 to the financial statements.

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#### Liquidity and Capital Resources

During the nine months ended September 30, 2008, working capital declined by \$2,951,500 to a deficit balance of \$21,793,700. The decline is due primarily to the increase in estimated fair value of derivative instrument liabilities discussed above.

In order to solve our liquidity problems, management has implemented a plan of financing its operations through the private placements of common shares, convertible debt, conversion of debt to common shares, and payment of consulting and other labor services with common shares. We obtained financing of \$2.06 million and \$2.0 million in 2007 and 2006, respectively, through the issuance of callable secured convertible debt. During the first nine months of 2008, we obtained financing of \$520,000 from the issuance of callable secured convertible debt. These funds provided for a portion of our working capital needs until the latter half of August 2008. Subsequent to September 30, 2008, we entered into litigation with the investors in the callable secured convertible debt. Consequently, further funding from this source is not anticipated.

In September 2008 we began a private placement of common stock or convertible debt to raise \$5 million. \$95,000 in common stock was received through September 30, 2008. The investor has the option to receive common stock at 80% of the market price per share (calculated at the average of the five closing bids prior to the investment) or convertible debt payable quarterly in common stock over three years for investments up to \$1 million and 5 years for investments exceeding \$1 million. The payment stock price is the greater of the average of the closing bid price for the five days before the payment, less 15% for investments up to \$1 million and 18% for investments exceeding \$1 million or \$0.0015 per share. Interest at 9% compounded annually accrues on the principal and accrued interest.

We are actively working to establish a longer term financing plan that will identify capital sources for our financing needs over a three to five year period. Once this plan is established, needs for financing will be adjusted and the plan will be updated annually.

In addition to continuing the above described efforts, development of the technology necessary to manufacture fertilizer from photochemicals has been completed. In March 1998 our subsidiary, Itronics Metallurgical, Inc., signed a definitive manufacturing and distribution agreement with Western Farm Services, Inc. (WFS). The agreement gives WFS the exclusive license and right to manufacture and market the GOLD n GRO line of fertilizer products in the

states of Arizona, California, Hawaii, Idaho, Oregon and Washington. The agreement is for five years, with five year renewal options. In March 2008, the companies entered the third five year term of the agreement.

In addition, 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, 2008, no factored inventory and receivables were outstanding.

We are expanding GOLD n GRO fertilizer sales and the related photochemical and silver sales necessary to achieve profitability, but this growth 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

With the successful completion of the initial pioneering development work by the GOLD n GRO Fertilizer segment, and with the launch of the insidemetals.com 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 2007 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, automation of certain manufacturing functions, and expansion of silver refining capacity in two stages. Expansion is being done incrementally as fertilizer sales continue to grow.

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

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

7. Continue facilities expansion and technology development.

8. Acquire established companies and/or their technologies.

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

1. Increase sales in established market segments.

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

a. Specialty Agriculture which includes Avocados, Citrus, Grapes, Fruit and Nut Trees, and Vegetables.

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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.

In the second quarter 2008 the parent company of our distributor acquired a major competitor. Early in the third quarter the parent company disclosed plans to integrate the acquired company and its retail outlets into its existing retail distribution system. Prior to the acquisition our distributor and its sister subsidiaries had more than 500 retail outlets nationwide. After the merger there are more than 800 retail outlets nationwide.

Our distributor, which sells the GOLD n GRO fertilizers in Arizona, California, Hawaii, Idaho, Oregon, and Washington, is acquiring new retail outlets in those states. The increase in the number of retail outlets is expected to contribute to further increases in GOLD n GRO sales in the fourth quarter of this year and in 2009. Consideration is being given to putting the GOLD n GRO products into a national sales program operated by a subsidiary of the acquired company. While a commitment has not been made, we have received inquiries from some of the newly acquired retail outlets in the southern and eastern U.S. about the availability of the GOLD n GRO fertilizers, and GOLD n GRO Guardian Deer Repellent. The Company believes that moving the GOLD n GRO product line into a national sales program could have a major positive impact on the growth of GOLD n GRO fertilizer sales.

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

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

We are continuing to assist with field trials being performed by our distributor s agronomy personnel in Utah and California. We are supporting field trials for GOLD n GRO Guardian with potential distributors in several states



beginning in the third quarter 2008.

In the fall of 2007 we began a field evaluation of using GOLD n GRO 10-0-1+3% Manganese as a manganese fertilizer that could be applied as a spray tank mix with glyphosate(Round Up) on "Round Up" ready corn. This is important because most manganese fertilizers are not compatible with glyphosate in spray tank mixes. The GOLD n GRO fertilizer was found to be compatible and no phyto-toxicity to the corn plants was experienced. The grower was pleased with the trial results. Subsequent to that, in the first half 2008, the Company has been working with a fertilizer raw material supplier who has put out trials on "Round Up Ready" soybeans in several states. Results have not yet been reported, but the supplier has an extensive nationwide

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distribution system and is fully capable of introducing the GOLD n GRO fertilizer in relevant markets in the mid-west and southern United States where soybeans are a major crop.

If the GOLD n GRO 10-0-1+3% Manganese proves to work with glyphosate for spray application on "Round Up Ready" soybeans, then three large acreage markets will become available for sales development. These are: (1) "Round Up Ready" silage corn, (2) "Round Up Ready" corn for grain, and (3) "Round Up Ready" soybeans. The bulk of acreage for these crops is in the mid-west and southern areas of the United States. There is typically one crop per year, and the demand would be highly seasonal on a relatively large scale, and pre-season manufacturing of product inventory would be required.

During the past two years our agronomy staff has been conducting literature research specific to phosphorous availability and the related availability of nutrient metals that are placed in the soil by fertilization. The objective of this research is to establish a theoretical foundation that explains why components of the demetallized photoliquids used to make the GOLD n GRO liquid fertilizers are beneficial when applied. The research has identified many studies that have been conducted relevant to this chemistry. The outcome is that the unique chemistry found in the GOLD n GRO fertilizers is beneficial when applied to the soil by improving the availability of phosphorous and the nutrient metals, including iron, zinc, manganese, calcium, and magnesium. A related benefit is that residuals, to the extent they occur, are used as a nutrient source by soil microbes producing essentially complete use of the fertilizers. The main benefit of this nutrient technology is expected to be an ability to reduce the amount of fertilizer applied, while maintaining adequate nutrient levels in the crops being fertilized.

The other benefit of GOLD n GRO liquid fertilizer chemistry that is being identified is that it is making it possible to use phosphate-bearing fertilizer liquids in fertigation applications in locations that have hard water where this is not normally possible.

At a time in history when fertilizer prices, especially for phosphate, are rising sharply, the ability to improve the availability of phosphorous and nutrient metals in the soil has significant positive economic and environmental benefits.

These developments with their associated economic and environmental benefits are expected to lead to expanded use of the GOLD n GRO liquid fertilizers for fertigation applications on a number of crops, and to increase the use of the fertilizers with phosphate applications on many different crops.

In 2006 we began contributing to an ongoing Zinc Nutrition Research Program at Utah State University in Logan, Utah. To date, the research has demonstrated the effectiveness of GOLD n GRO 9-0-1+7% Zinc as a chelated liquid zinc micronutrient fertilizer for zinc deficient corn. Results include preventing visual symptoms of zinc deficiency, significantly increased tissue concentration of zinc compared to untreated plants, and doubled dry mass.

### 3. Expand sales to new territories.

The GOLD'n GRO products are being sold in Arizona, California, Colorado, Idaho, Nevada, Oregon, Rhode Island, Washington, and Utah, with the majority of our sales in central California. 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. Based on our experience, commercial sales can be

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generated approximately one to three years 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 requires the same procedural approach.

The expansion into the Northwest states of Idaho, Oregon, Washington, and Utah is being managed by one field agronomist. 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.

In general, expansion to new regions of the country will require at least one field agronomist for each new 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. 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.

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 are marketing one type of fertilizer injector to our "e" store, which is the first step into this market. Additionally, fertilizer injectors are available to consumers through irrigation supply stores.

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

We are introducing two new specialty products, a calcium plus magnesium fertilizer named GOLD n GRO 11-0-0+5% Ca (Calcium) and a high magnesium content fertilizer named GOLD n GRO 8-0-0+3% Mg (Magnesium), both targeting foliar and soil application. We have registered both fertilizers in Nevada and California.

We are working with our distributors in California to introduce a new chelated micronutrient fertilizer which is GOLD n GRO 9-0-0 Iron Man Z. This fertilizer is being targeted to the turf and ornamental market and for use on vegetables, trees, and vines. Addition of this fertilizer to the GOLD n GRO line of chelated micronutrients fills a nutrient gap and was generated by customer requests for such a product. The Company is now offering five chelated micronutrient fertilizers for sale. The GOLD n GRO product line now includes a total of 13 liquid multi-nutrient fertilizers.

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 \$200 million in annual sales. Products currently in the market have limited effectiveness so we believe that 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.

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We acquired ownership interest in the GOLD n GRO Guardian trademark, product rights, and the repelling product in 2005. We now own 100% of all rights related to GOLD n GRO Guardian. Currently, this product line is strictly for non-food plant applications. We have engaged consultants experienced in the EPA registration process. We are presently working with them to plan the process and lab work needed to complete a series of registrations.

We have a three phased registration process underway to get the repelling ingredient (denatonium benzoate) and GOLD n GRO Guardian into the market.

### Phase 1

is to register a "ready-to-use" spray deer repellent that is essentially similar in the amount of repelling ingredient to a topical product that is already in the market, but that is being phased out due to high cost and limited effectiveness. Using this "me too" approach provides a U.S. EPA approved path to rapid registration to get product sales started by mid-year 2008. This phase was completed in March 2008. An amendment to this label that allows use with GOLD n GRO 8-8-8+4%S fertilizer was received in September 2008. Use with the fertilizer makes the product systemic so that the treatment lasts more than 8 weeks and does not wash off in the rain.

### Phase 2

is to register denatonium benzoate. U.S. EPA has made a written determination that Itronics would have a 10 year exclusive use right under this registration that provides use protection to the owner which is similar to use protection provided by a product patent. This registration is being pursued because denatonium benzoate has not been registered as an active ingredient for use in animal repellents in the United States, and the U.S. EPA is now requiring that it be registered for that purpose. This registration requires that scientific, environmental, and toxicology data be gathered to become part of the application. We have an agreement in place with a large foreign manufacturer of denatonium benzoate who has already supplied certain confidential technical manufacturing and scientific information to U.S. EPA as part of our product registration application. Our environmental consultants have informed us that the data required will take from two to four years of elapsed time to gather and could cost in the range of \$1 million to \$1.5 million. This registration is on hold until the data requirements can be fulfilled.

### Phase 3

is to register the GOLD n GRO Guardian deer-repellent fertilizer concentrate. This registration will be pursued once denatonium benzoate has been registered as an active ingredient for use in animal repellents in the United States. This registration requires that scientific, environmental, and toxicology data be gathered to become part of the application. A major part of the toxicology studies for this product have been completed with a finding that the product is relatively safe, requiring only a caution label for use. Some of the scientific data has been supplied, but the environmental data has not yet been gathered.

### State Registration

We also need to register GOLD n GRO Guardian in each state in which it will be sold. We have already registered the fertilizer component, GOLD n GRO 8-8-8+4%S, in Nevada, Utah, and 9 northeastern states where sales will be started so that the fertilizer registration requirements will not delay sales once they are permissible. State registration of the "ready-to-use" spray as registered with the U.S. EPA was begun in early May 2008. The plan is to file registration applications in 13 states. Sales of GOLD n GRO Guardian can begin in each state when the state registration is received. To date, our registration applications have been approved in Nevada, Utah, Rhode Island, Colorado, Massachusetts, New Jersey, Maryland, Alabama, Delaware, and Pennsylvania.

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The Company is actively working on GOLD n GRO Guardian packaging for early customer use. It is also qualifying potential distributors in the states where registration has been received. The amount of GOLD n GRO Guardian Deer Repellent that can be sold under the first label registration is limited. Based on interest being expressed in the product, the Company believes that it could quickly move into a "sold out" position on the product until the second registration is completed. Because of this, we are selecting as initial distributors, the companies that appear to have the best long term potential to grow when more supply becomes available. Also because of this, the Company plans to only focus on licensed landscape maintenance companies that have licensed spray divisions as initial customers, along with tree and decorative plant nurseries in those states in which we are registering the product.

During the third quarter of 2008 several shipments of one-gallon spray kits have been made to qualified Landscape Maintenance businesses that are licensed for spraying pesticides in states where GOLD n GRO Guardian Deer Repellent is registered. Reports from trials underway indicate the spray applications are exceeding expectations. In one trial, the leaves of sprayed and unsprayed trees were tested about six weeks after application and the leaves of the sprayed trees were appropriately bitter. In another trial, the customer reported satisfaction with the first application and is purchasing more spray kits. In a third trial, the customer reported no evidence of deer damage in the sixth week after application and has ordered more spray kits, and is expanding its evaluation and testing program.

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.

We are developing applications of 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.

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7. Continue facilities expansion and technology development.

As fertilizer sales volume increases, we 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. The first phase, construction of a containment area, was substantially completed in late 2006.

While we believe that we can handle expected growth in 2008 with the existing load-out module, we hope to complete installation of the new load out tanks during the first half of 2009, subject to the availability of financing. The estimated capital required for this project is \$400,000.

Planning is underway to increase our silver refining capacity in two stages, from 24,000 troy ounces per year to 2.4 million troy ounces annually, a 100 times increase. Production at capacity with \$10 per troy ounce silver would increase silver sales from \$240,000 per year to \$24 million.

Stage 1 involves installing a new leaching circuit in 2009 which will reduce the amount of solids delivered to the refining operation by 90 percent, while at the same time producing even cleaner liquid raw materials for GOLD n GRO fertilizer manufacturing. Stage 2 is to install a new modular melting system in 2010 which will reduce melt cycle times, reduce cost, and increase physical capacity by up to 10 times.

Stage 1 will increase the per melt capacity of the refining operation by 10 times with no increase in per melt cost. This produces a 90 percent reduction of the per melt cost of each ounce of silver produced. Stage 2, installation of the new melting system, will further reduce the per melt cost and substantially increase operational efficiencies. This two stage capacity expansion will not only reduce direct operating costs, but will also reduce "in process inventories" which will reduce working capital requirements and improve the rate of inventory turnover, major financial benefits to the Company and its shareholders.

The increase in silver refining capacity will require related expansion and improvement of materials handling capabilities at our facility. We are estimating that each of the two stages of expansion can be completed for \$500,000, for a combined capital investment of \$1 million. Each installation is expected to take about 8 months to complete. This relatively modest investment is made possible because we already have two permitted locations within the facility for these new operations.

During the second quarter, we completed pilot leach tests which show that the leach process we are developing will increase per melt refining capacity by up to 10 times and reduce per ounce refining cost up to 90 percent.

A silver-iron-zinc-sulfur concentrate is presently produced by our photoliquid demetallization process. The concentrate is dried and sent to the refinery for silver recovery, refining, and sale. The concentrate has a relatively low silver content in relation to the iron and sulfur. Presently some of the iron and zinc goes into a glass slag and some of the iron and zinc combines with the sulfur to form an "iron matte," which has some silver in it and which must be reprocessed to recover the remaining silver.

The purpose of the new technology is to remove the iron, zinc, and the sulfur from the concentrate to reduce the amount of concentrate sent to the refinery, and to reduce the amount of glass slag and iron matte produced by the refinery. The expected financial benefits of the

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process are to: (1) increase per melt silver refining capacity by up to 10 times with no increase in per melt cost by reducing the amount of silver concentrate sent to the refinery by up to 90 percent; (2) reduce waste by producing an iron-zinc bearing liquid (Itromet FeLix Process), and a sulfur bearing liquid (Itromet SuLix Process) that can be used as raw materials in GOLD n GRO fertilizers.

Small pilot scale leaching tests conducted in the first half of 2008 are producing a recovery of iron and zinc of more than 85 percent and up to 90 percent of the contained sulfur. The bulk volume of the residual silver bearing solids is reduced by up to 90 percent. The residual solids contain all of the silver along with other non-nutrient impurities. With a 90 percent reduction in bulk volume, the melting furnace will now be able to produce up to 10 times more silver with each melt, at no increase in cost. The other positive outcome is that the iron, zinc, and sulfur content in the

produced liquids is high enough to work well for GOLD n GRO fertilizer manufacturing. This will help stabilize some of our fertilizer raw material costs once it is implemented.

We are now working on the Stage 1 leach plant design, preparing a capital budget, and a construction schedule. We project the leach plant can be built within eight months after obtaining capital funding, which is estimated at \$380,000. Related improvements in the refinery will add another \$120,000 for a total budget of \$500,000.

We have identified several other potential applications where the FeLix and SuLix processes could reduce processing costs and reduce waste by profitably converting material presently being wasted into commercial products:

Processing steel wool (ion exchange) cartridges which are widely used in the United States to perform on site silver removal from photographic liquids at user sites where hauling is not required. Both iron and silver would be recovered. This is a large source of iron and photo silver.

Processing the cores of non-mercury bearing silver batteries to recover zinc and silver.

Processing the cores of non-mercury bearing alkaline batteries to recover zinc and manganese.

Processing flue dusts produced by steel mills to recover zinc and iron. This is a potentially large future use.

Processing of concentrates produced by certain silver-zinc mines. While this would require more application development work to match the processes to specific concentrates, its potential is huge.

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. Further acquisitions will depend on the potential benefits and suitable financing.

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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:

- Continue to provide consulting services.
- "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.

a. Continue to provide consulting services

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. These efforts resulted in two consulting projects during the first nine months of 2008. One project has been completed and has a small potential for future services, and the other project may resume and continue for two to three months. Resumption of this work is subject to the client obtaining additional financing.

b. "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 is beginning to 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.

A program to solicit advertising customers was developed and is being offered to gold exploration companies.

In September 2007, our Board of Directors approved the formation of a subsidiary to acquire multi-mineral properties and strategic small specialty companies that are in early stage or commercial operation. These can be combined to form a larger operating company that will utilize our advanced environmentally compatible technologies to mine, extract, and sell mineral and metal products from multi-mineral properties. Our plan anticipates that shares in the subsidiary will be placed with private investors. The plan will include provisions for taking the subsidiary public to provide an exit strategy for the initial private investors.

Item 4T. 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 principal executive and financial officer and principal accounting 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 principal executive and financial officer and principal accounting officer concluded that because of the material weakness in internal control over financial reporting described below, our disclosure controls and procedures were not effective as of September 30, 2008.

Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms promulgated by the SEC and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating and implementing possible controls and procedures.

## Accounting and Reporting Oversight

Because of our small size, we have ineffective segregation of duties relative to key financial reporting functions. Additionally, only one person in our company, our Principle Accounting Officer/Controller has extensive US GAAP accounting and SEC reporting experience. However, we do not have anyone else on staff with sufficient knowledge to review his work for completeness and accuracy. We do not have anyone with financial expertise on our Board so we have been unable to form an audit committee to perform oversight of this function.

In order to correct the foregoing weaknesses, we will continue to search for independent directors; however, given our current financial condition, we expect we will not be successful until we can become profitable and/or adequately funded.

(b) Changes in internal controls. There was no change in our internal controls or in other factors that could affect these controls during our fiscal quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II- OTHER INFORMATION

### Item 1. Legal Proceedings

On October 10, 2008, we received a Notice of Default from AJW Partners, LLC, New Millenium Capital Partners II, LLC, AJW Offshore, Ltd., AJW Qualified Partners, LLC, and AJW Master Fund, Ltd. (collectively, the "plaintiffs"), claiming that we were purportedly in default of certain obligations under the Company's notes issued to the plaintiffs. On October 16, 2008 the plaintiffs filed suit against the Company and its subsidiaries in the Supreme Court of the State of New York alleging a breach of contract and other claims concerning certain agreements the Company has with those parties. The suit seeks in excess of \$5,000,000. We plan to vigorously defend these allegations and assert various counter-claims that it has against those plaintiffs.

As of September 30, 2008 we have accrued for liabilities, including interest, of \$561,972 which relate to various lawsuits and claims for the collection of the funds due. These include 8 leases totaling \$366,025 (reflected in Capital Lease Obligations) plus \$73,835 in additional interest (reflected in Accrued Interest) and one trade payable totaling \$85,801 (reflected in Accounts Payable) plus \$36,311 in additional interest (reflected in Accrued Interest). The leases are individually secured by specified equipment.

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

We have two cases, that originally sought \$171,853, 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, 2008, the recorded liability for these cases was \$162,795. We are delinquent in our payments under the respective settlement agreements, but are in contact with counsel for the creditor, and no collection action has been taken.

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 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 we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

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

(a) Recent Sales of Unregistered Securities:

In September 2008, we issued an aggregate of 63,333,333 shares of common stock valued at \$95,000 to John W. Whitney, our President, upon conversion of cash loans previously made to the Company and its subsidiaries. In September 2008 we also issued an aggregate 16,666,666 shares of common stock valued at \$25,000 to Dr. Whitney for a cash investment made in the current Private Placement. The price of \$0.0015 used for both of these issuances is the price presently being offered in a Private Placement to accredited investors. Dr. Whitney has an additional \$108,025 in loans to the Company that he may convert into the Private Placement at the price of \$0.0015 as long as it is in effect under those terms.

On September 26, 2008 employees listed in the table below were granted a ten year option to acquire the below listed shares at \$0.002 per share. The options became effective on September

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30, 2008 and vested immediately. The number of options granted was based on the individual s deferred salary and principal amount of loans as of September 30, 2008 and was calculated at 100,000 shares for each \$1,000 of deferred salary and loan principal. This is the same calculation being used to determine the number of warrants to be issued to holders of the Series 2000 convertible debt that is currently being offered to the Noteholders to restructure their Notes. In addition, these employees can convert their deferred salary, loans, or accrued interest into common stock at the closing trade price on the date of conversion. Issuance of shares due upon conversion of deferred salary will be delayed pending the Company receiving adequate funds to pay the related payroll taxes. The amounts of deferred salary that were converted as of September 30, 2008 are included in the following table:

|                 |                       | Deferred     |                |                  |               |
|-----------------|-----------------------|--------------|----------------|------------------|---------------|
|                 |                       | Salary       | No. of         | Deferred         |               |
|                 |                       | and          | Options        | Salary           | No. of        |
|                 | <u>Position</u>       | <u>Loans</u> | <u>Granted</u> | <u>Converted</u> | <u>Shares</u> |
| John W. Whitney | President             | \$1,006,341  | 100,634,123    | \$120,000        | 66,666,666    |
| Duane Rasmussen | Former Vice President | 652,500      | 65,250,000     | 250,000          | 138,888,888   |

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|                    |            |             |             |           |             |
|--------------------|------------|-------------|-------------|-----------|-------------|
| Michael<br>Horsley | Controller | 288,100     | 28,810,000  | 70,000    | 38,888,888  |
|                    |            | \$1,946,941 | 194,694,123 | \$440,000 | 244,444,442 |

In October 2008, we issued an aggregate of 375,000 shares of common stock valued at \$1,500 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 2008

In October 2008, we issued an aggregate of 10,000 shares of common stock valued at \$40 to one of our employees as compensation for services performed on our behalf in his capacity as an employee of our Company for the second quarter of 2008.

We issued options to purchase an aggregate of 25,000 shares of common stock to one of our employees in August 2008. The options are exercisable at \$0.20 per share and expire in ten years from grant.

In late September 2008, the Company began offering an extension and payoff plan to the holders of Series 2000 Convertible Notes and other similar outstanding Notes. The plan includes paying the principal and accrued interest in equal quarterly payments with common stock over approximately 17 quarters. The number of shares for each payment will be determined based on the average of the closing bid price for the five trading days preceding the payment or \$0.0015, whichever is higher. In addition, the Noteholders will receive one year warrants to acquire restricted common stock at \$0.005 per share, with the number of warrants to be calculated at 100,000 shares per \$1,000 of Note principal in exchange for extending the Notes and for reducing the interest rate from 12% to 6%. As of September 30, 2008 the principal amount of the Notes was \$1,437,000 and the accrued interest was \$2,379,135, for a combined total of \$3,816,135. If all the Noteholders accept the plan, the number of common shares to be

acquired by exercising the warrants is 143,700,000, which will provide gross proceeds to the Company of \$718,500.

As of October 1, 2008, Noteholders with \$210,000 in principal and \$308,038 in accrued interest, or a total of \$518,038, have accepted the plan.

The first quarterly payment to these Noteholders was made in early October 2008 and totaled 20,000,000 common shares in payment of \$33,600 in Note principal.

In July 2008, we issued an aggregate of 49,790,000 common shares to four accredited investors upon the conversion of \$49,790 in callable secured convertible notes.

In July 2008, we issued an aggregate of 26,000,000 common shares to four accredited investors upon the conversion of \$18,200 in callable secured convertible notes.

In July 2008, we issued an aggregate of 26,000,000 common shares to four accredited investors upon the conversion of \$17,160 in callable secured convertible notes.

In July 2008, we issued an aggregate of 10,000,000 common shares to four accredited investors upon the conversion of \$6,400 in callable secured convertible notes.

In July 2008, we issued an aggregate of 45,013,000 common shares to four accredited investors upon the conversion of \$28,808 in callable secured convertible notes.

In July 2008, we issued an aggregate of 55,013,900 common shares to four accredited investors upon the conversion of \$33,558 in callable secured convertible notes.

In July 2008, we issued an aggregate of 55,013,900 common shares to four accredited investors upon the conversion of \$30,258 in callable secured convertible notes.

In August 2008, we issued an aggregate of 55,013,900 common shares to four accredited investors upon the conversion of \$23,656 in callable secured convertible notes.

In August 2008, we issued an aggregate of 75,439,500 common shares to four accredited investors upon the conversion of \$30,176 in callable secured convertible notes.

In August 2008, we issued an aggregate of 75,439,500 common shares to four accredited investors upon the conversion of \$24,141 in callable secured convertible notes.

On August 6, 2008, the Company entered into a Securities Purchase Agreement with three accredited investors (the "Investors") for an aggregate amount of (i) \$210,000 in secured convertible notes, and (ii) warrants to purchase 20,000,000 shares of the Company's common stock (the "Financing"). The Company anticipates that the proceeds of the Financing will be used to advance its eight part business plan which was summarized in its press release issued by the Company on June 3, 2005. The Financing will provide working capital to expand GOLD n GRO

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fertilizer sales, EPA registration of the GOLD n GRO Guardian deer repellent fertilizer, certain capital improvements to expand production capacity, and payment of existing debt obligations.

The Financing was made in reliance upon an exemption from securities registration afforded by the provisions of Section 4(2), Section 4(6) and/or Regulation D as promulgated by the United States Securities and Exchange Commission under the Securities Act of 1933, as amended.

The Financing was completed in one closing. The closing consisted of gross proceeds of \$210,000, less financing costs of \$10,000, for net proceeds of \$200,000.

The Investors received three year convertible notes (the "Notes") bearing simple interest at 12% per annum. The Notes are convertible into the Company's common stock at a price equal to the lesser of (i) \$0.10 or (ii) 30% of the average of the lowest 3 trading prices during the 20 trading day period ending one trading day before the conversion date. In addition, we granted the Investors a further security interest in substantially all of our assets, including the assets of our wholly owned subsidiaries, and intellectual property.

The parties entered into a Registration Rights Agreement whereby we may be required to file a registration statement with the Securities and Exchange Commission within 10 days of written demand, registering the common stock underlying the secured convertible notes and the warrants. If the registration statement is not declared effective within 90 days from the filing date, we are required to pay liquidated damages to the investors. In the event that we breach any representation or warranty in the Securities Purchase Agreement, we may be required to pay liquidated damages in shares or cash, at our election, equal to two percent of the outstanding principal amount of the secured convertible notes per month plus accrued and unpaid interest.

The Investors received seven year warrants to purchase a total of 20,000,000 common shares of the Company at a purchase price of \$0.001 per share.

Other than under these Agreements and under certain specified circumstances, should we issue shares of common stock below the market price, the exercise price of the warrants will be reduced accordingly.

The conversion price of the secured convertible notes and the exercise price of the warrants may be adjusted in certain circumstances such as if we pay a stock dividend, subdivide or combine outstanding shares of common stock into a greater or lesser number of shares, or take such other actions as would otherwise result in dilution of the selling stockholder's position.

The Investors have agreed to restrict their ability to convert their secured convertible notes or exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by them in the aggregate and their affiliates after such conversion or exercise does not exceed 4.9% of the then issued and outstanding shares of common stock.

The Company paid a finder's fee of 8% of the net proceeds.

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Additionally, the conversion discount rate on the new and all previous Notes was increased from 65% to 70%, and the interest rate on the new and all previous notes was increased to 12% retroactively to January 1, 2008.

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, our business associates or our executive officers, and we restricted transfers in accordance with the requirements of the Securities Act of 1933, as amended. 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 Item 2 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 were in default. The total principal and interest due at September 30, 2008 is \$3,816,135. In September 2008 the Company began a plan to extend the Notes for four years and a day by offering to pay the principal and accrued interest with common stock in 17 quarterly installments. The stock is priced at the greater of the average of the five closing bids prior to the payment date or \$0.0015 per share. In addition, the interest rate is reduced from 12% to 6% and Noteholders agreeing to the extension receive one year warrants to acquire 100,000 shares of common stock per \$1,000 of original principal amount at an exercise price of \$0.005 per share. If all the Noteholders agree to the extension, warrants to acquire a total of 143,700,000 common shares will be issued.

As of September 30, 2008 Noteholders holding a total of \$444,299 in principal and accrued interest extended their Notes and warrants to acquire 18,000,000 common shares were issued. Subsequent to September 30, 2008, principal and accrued interest totaling \$788,060 were extended and warrants to acquire 32,000,000 common shares were issued. The Notes that have not been extended remain in default, but no collection action has been taken.

The Company's mortgage loan on the manufacturing facility is in default due to delinquent property taxes totaling \$18,661. The lender is aware of the situation and has taken no collection action. As a result of the default, the entire

principal balance, in the amount of \$398,434, is included in current liabilities. In addition, the Company's semi-annual payment on a City of Reno Special Assessment District loan in the amount of \$4,284 is delinquent. As a result, the entire principal balance in the amount of \$83,962 is included in current liabilities.

As of September 30, 2008 the Company owed \$88,669 for federal payroll taxes. \$12,046 of this amount was paid subsequent to September 30, 2008. The Company is in contact with the IRS and believes a payment arrangement can be made for the remaining balance due. The IRS has filed

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federal tax liens and may seize Company assets if satisfactory arrangements cannot be made.

In addition to the above leases that are subject to litigation, there are two leases, with a recorded liability of \$107,007, that are in default. As required by U.S. Generally Accepted Accounting Principles, the principal balance of the leases that are in default have been classified as current liabilities.

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Item 6. Exhibits

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|--------------|---|----|
| Exhibit 31.1 | CERTIFICATION OF PRINCIPAL EXECUTIVE AND FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002  | 49 |
| Exhibit 31.2 | CERTIFICATION OF PRINCIPAL ACCOUNTING OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002               | 51 |
| Exhibit 32.1 | CERTIFICATIONS OF PRINCIPAL EXECUTIVE AND FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002 | 53 |
| Exhibit 32.2 | CERTIFICATIONS OF PRINCIPAL ACCOUNTING OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002              | 54 |

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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 14, 2008

By: /S/JOHN W. WHITNEY

John W. Whitney

President

(Principal Executive and Financial

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 14, 2008

By: /S/JOHN W. WHITNEY

John W. Whitney

President

(Principal Executive and Financial

Officer)

DATED: November 14, 2008

By: /S/MICHAEL C. HORSLEY

Michael C. Horsley

Controller

(Principal Accounting Officer)