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ALANCO TECHNOLOGIES INC  
Form 10QSB  
May 16, 2005

ALANCO TECHNOLOGIES, INC.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-QSB

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

EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2005

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-9347

ALANCO TECHNOLOGIES, INC.  
-----

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

Arizona  
-----

(State or other jurisdiction of incorporation or organization)

86-0220694  
-----

(I.R.S. Employer Identification No.)

15575 N. 83rd Way, Suite 3, Scottsdale, Arizona 85260  
-----

(Address of principal executive offices) (Zip Code)

(480) 607-1010  
-----

(Issuer's telephone number)

-----  
(Former name, former address and former fiscal year,  
if changed since last report)

State the number of shares outstanding of each of the issuer's classes of  
common equity, as of the latest practicable date:

As of May 1, 2005 there were 26,095,200 shares, net of  
-----

treasury shares, of common stock outstanding  
-----

Transitional Small Business Disclosure Format (Check one): Yes No X  
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Forward-Looking Statements: Some of the statements in this Form 10-QSB Quarterly  
Report, as well as statements by the Company in periodic press releases, oral  
statements made by the Company's officials to analysts and shareholders in the  
course of presentations about the Company, constitute "forward-looking  
statements" within the meaning of the Private Securities Litigation Reform Act

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of 1995. Words or phrases denoting the anticipated results of future events such as "anticipate," "believe," "estimate," "will likely," "are expected to," "will continue," "project," "trends" and similar expressions that denote uncertainty are intended to identify such forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Such factors include, among other things, (i) general economic and business conditions; (ii) changes in industries in which the Company does business; (iii) the loss of market share and increased competition in certain markets; (iv) governmental regulation including environmental laws; and (v) other factors over which the company has little or no control.

ALANCO TECHNOLOGIES, INC.

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### ALANCO TECHNOLOGIES, INC.

#### CONDENSED CONSOLIDATED BALANCE SHEETS AS OF MARCH 31, 2005 AND JUNE 30, 2004

	March 31, 2005	June 30, 2004
	-----	-----
ASSETS		
	(unaudited)	
CURRENT ASSETS		
Cash and cash equivalents	\$ 613,000	\$ 1,975,600
Accounts receivable, net	1,053,500	657,200
Notes receivable, current	45,000	-
Inventories, net	2,257,600	2,282,300
Prepaid expenses and other current assets	411,400	110,600
	-----	-----
Total current assets	4,380,500	5,025,700
	-----	-----
PROPERTY, PLANT AND EQUIPMENT, NET	257,000	247,500
	-----	-----
OTHER ASSETS		
Goodwill and other intangible assets, net	5,935,100	6,048,000
Long-term notes receivable, net	11,000	68,000
Net assets held for sale	107,400	156,100
Other assets	35,300	40,600
	-----	-----
Total other assets	6,088,800	6,312,700
	-----	-----
TOTAL ASSETS	\$ 10,726,300	\$ 11,585,900
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 1,563,200	\$ 1,246,500
Notes payable and capital leases, current	-	5,200
Billings in excess of cost and est earnings on uncompleted contracts		25,800
Deferred revenue, current	105,200	27,200
	-----	-----
Total Current Liabilities	1,668,400	1,304,700
	-----	-----
LONG TERM LIABILITIES		
Notes payable and capital leases, long term	814,100	814,100
Preferred Stock - Series B, 66,300 and 61,500 shares issued and outstanding, respectively	650,000	602,800

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TOTAL LIABILITIES	3,132,500	2,721,600
SHAREHOLDERS' EQUITY		
Preferred Stock - Series A Convertible, 2,781,200 and 2,476,800 shares issued and outstanding, respectively	3,412,700	2,956,100
Common Stock- 25,995,400, and 23,232,800 shares outstanding, net of 500,000 shares of Treasury Stock	70,619,700	68,959,600
Accumulated deficit	(66,438,600)	(63,051,400)
Total shareholders' equity	7,593,800	8,864,300
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	\$ 10,726,300	\$ 11,585,900

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE THREE MONTHS ENDED MARCH 31, (Unaudited)

	2005	2004
NET SALES	\$ 1,531,200	\$ 1,221,100
Cost of goods sold	975,300	780,000
GROSS PROFIT	555,900	441,100
Selling, general and administrative expense	1,712,200	1,173,700
OPERATING LOSS	(1,156,300)	(732,600)
OTHER INCOME & EXPENSES		
Interest expense, net	(11,200)	(21,500)
Other income, net	63,900	9,000
LOSS FROM OPERATIONS	(1,103,600)	(745,100)
Preferred stock dividends-paid in kind	(252,000)	(218,200)
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ (1,355,600)	\$ (963,300)
NET LOSS PER SHARE - BASIC AND DILUTED		
- Net loss attributable to common shareholders	\$ (0.05)	\$ (0.05)

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WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	25,514,500	17,875,500
	=====	=====

See accompanying notes to the consolidated financial statements

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### ALANCO TECHNOLOGIES, INC.

#### CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE NINE MONTHS ENDED MARCH 31, (Unaudited)

	2005	2004
	-----	-----
NET SALES	\$ 5,353,900	\$ 3,492,600
Cost of goods sold	3,493,500	2,180,600
	-----	-----
GROSS PROFIT	1,860,400	1,312,000
Selling, general and administrative expense	4,779,800	3,445,900
	-----	-----
OPERATING LOSS	(2,919,400)	(2,133,900)
OTHER INCOME & EXPENSES		
Interest expense, net	(38,800)	(128,600)
Other income, net	74,700	48,300
	-----	-----
LOSS FROM OPERATIONS	(2,883,500)	(2,214,200)
Preferred stock dividends-paid in kind	(503,700)	(245,200)
	-----	-----
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	\$ (3,387,200)	\$ (2,459,400)
	=====	=====
NET LOSS PER SHARE - BASIC AND DILUTED		
- Net loss attributable to common shareholders	\$ (0.13)	\$ (0.15)
	=====	=====
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	25,118,000	16,479,500
	=====	=====

See accompanying notes to the consolidated financial statements

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CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN CERTAIN SHAREHOLDERS' EQUITY AND

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STOCK ACCOUNTS FOR THE NINE MONTHS ENDED MARCH 31, 2005 (Unaudited)

	Common Stock		Preferred Stock - Ser A		Pre - Shar
	Shares	Dollars	Shares	Dollars	
	-----		-----		-----
Balances at 06/30/04	23,732,800	\$ 69,334,700	2,476,800	\$ 2,956,100	61,5
Preferred dividends paid in kind	-	-	304,400	456,600	4,8
Shares issued for services and prepayments	324,400	286,600	-	-	-
Options and Warrants exercised	2,438,200	1,333,100	-	-	-
Other	-	40,400	-	-	-
	-----		-----		-----
Balances at 03/31/05	26,495,400	\$ 70,994,800	2,781,200	\$ 3,412,700	66,3
	=====		=====		=====

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited) FOR THE NINE MONTHS ENDED MARCH 31

	2005	2004
	-----	-----
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Loss from operations	\$ (2,883,500)	\$ (2,214,200)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	257,300	257,600
Stock issued for services	73,300	68,800
Income from assets held for sale	(74,800)	(17,600)
Gain on disposal of asset	-	(1,000)
Changes in:		
Accounts receivable, net	(396,300)	(3,300)
Inventories, net	24,700	(840,700)
Costs in excess of billings and estimated earnings on uncompleted contracts	(49,900)	(64,200)
Accounts payable and accrued expenses	316,700	62,100
Deferred revenue	78,000	(41,700)
Billings and estimated earnings in excess of costs on uncompleted contracts	(25,800)	-
Other assets	5,300	12,300
	-----	-----
Net cash used in operating activities	(2,689,300)	(2,856,600)
	-----	-----
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Net cash from assets held for sale	123,400	70,000
Collection of notes receivable, net	12,000	195,000
Purchase of property, plant and equipment	(101,700)	(17,100)
Proceeds from the sale of property, plant		

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and equipment	-	5,200
Goodwill, acquisition	-	(5,000)
Patent renewal and other	(1,800)	-
	-----	-----
Net cash provided by investing activities	31,900	248,100
	-----	-----

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)  
FOR THE NINE MONTHS ENDED MARCH 31, (Continued)

	2005	2004
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances on borrowings	\$ -	\$ 2,054,500
Repayment on borrowings	(5,200)	(2,159,900)
Subscriptions receivable	-	899,200
Net proceeds from sale of Preferred Stock	-	102,400
Net proceeds from sale of Common Stock	1,300,000	1,641,000
	-----	-----
Net cash provided by financing activities	1,294,800	2,537,200
	-----	-----
NET DECREASE IN CASH	(1,362,600)	(71,300)
CASH AND CASH EQUIVALENTS, beginning of period	1,975,600	97,700
	-----	-----
CASH AND CASH EQUIVALENTS, end of period	\$ 613,000	\$ 26,400
	=====	=====
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION		
Net cash paid during the period for interest	\$ 38,800	\$ 69,700
	=====	=====
Non-Cash Activities:		
Shares issued in payment of accounts payable	\$ -	\$ 245,000
	=====	=====
Value of stocks and warrants issued for services	\$ 336,800	\$ 68,800
	=====	=====
Value of warrants issued for credit line extension	\$ 23,300	\$ -
	=====	=====
Series B preferred stock dividend, paid in kind	\$ 47,200	\$ 41,900
	=====	=====
Series A preferred stock dividend, paid in kind	\$ 456,600	\$ 203,200
	=====	=====

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Value of treasury stock redeemed in preferred stock and warrant issuance	\$ -	\$ 198,400
	=====	=====
Value of treasury stock cancelled	\$ -	\$ 1,907,200
	=====	=====
Conversion of debt to equity	\$ -	\$ 250,000
	=====	=====

See accompanying notes to the consolidated financial statements

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### ALANCO TECHNOLOGIES, INC.

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE PERIOD ENDED MARCH 31, 2005

##### Note A - Basis of Presentation and Recent Accounting Pronouncements

Alanco Technologies, Inc., an Arizona corporation ("Alanco" or "Company"), operates in two business segments: Computer Data Storage Segment and RFID Technology Segment.

The unaudited condensed consolidated balance sheet as of March 31, 2005, the related unaudited condensed consolidated statements of operations for the three months and nine months ended March 31, 2005 and the related unaudited condensed consolidated statement of cash flows for the nine months ended March 31, 2005 presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions to Form 10-QSB. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. In our opinion, the accompanying condensed consolidated financial statements include all adjustments necessary for a fair presentation of such condensed consolidated financial statements. Such necessary adjustments consist of normal recurring items and the elimination of all significant intercompany balances and transactions.

These interim condensed consolidated financial statements should be read in conjunction with the Company's June 30, 2004, Annual Report on Form 10-KSB. Interim results are not necessarily indicative of results for a full year. Certain reclassifications have been made to conform prior period financials to the presentation in the current reporting period. The reclassifications had no effect on net loss.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statement and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

All stock options issued to employees have an exercise price not less than the fair market value of the Company's Common Stock on the date of grant. In accordance with accounting for such options utilizing the intrinsic value method under APB 25, there is no related compensation expense recorded in the Company's financial statements for the nine months ended March 31, 2005 and 2004. Had compensation cost for stock-based compensation been determined based on the fair value of the options at the grant dates consistent with the method of SFAS 123, the Company's net loss and loss per share would have been increased



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to the pro forma amounts presented below.

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ALANCO TECHNOLOGIES, INC.

	9 months ended March 31,	
	2005	2004
	-----	-----
Net loss, as reported	\$ (3,387,200)	\$ (2,459,400)
Add: Stock-based Employee compensation expense included in reported income, net of related tax effects	-	-
Deduct: Total stock-based Employee compensation expense determined under fair value based methods for all awards, net of related tax effects	\$ (178,050)	\$ (327,200)
Pro forma net loss	\$ (3,565,250)	\$ (2,786,600)
Net loss per common share, basic and diluted		
As reported	\$ (0.13)	\$ (0.15)
Pro forma	\$ (0.14)	\$ (0.17)
Weighted average common shares	25,118,000	6,479,500

During the nine months ended March 31, 2005, the Company granted employee stock options to purchase 420,000 shares of the Company's Class A Common Stock at an average purchase price of \$0.83, market price on date granted. The fair value of option grants is estimated as of the date of grant, in accordance with SFAS 123, utilizing the Black-Scholes option-pricing model, with the assumptions substantively utilized in the year-end financial statements.

Long-lived assets and intangible assets - The Company reviews carrying values at least annually or whenever events or circumstances indicate the carrying values may not be recoverable through projected discounted cash flows.

Recent Accounting Pronouncements -In November 2004, the FASB issued Statement No. 151 ("SFAS 151"), "Inventory Cost - An Amendment of ARB No. 43, Chapter 4." SFAS 151 clarifies accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. It requires that those items be recognized as current-period charges regardless of whether they meet the criterion of abnormal. Currently, we do not have any inventory items that fall into the classifications discussed, accordingly, adoption of SFAS 151 does not have a significant impact on our financial statements.

In December 2004, the FASB issued Statement No. 152 ("SFAS 152"), "Accounting for Real Estate Time-Sharing Transactions -- An Amendment of Statements 66 and 67." SFAS 152 amends SFAS 66 and 67 to reference the financial accounting and reporting guidance for real estate time-sharing transactions and to state that the guidance for incidental operations and costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. SFAS 152 is effective for financial statements for fiscal years beginning after June 15, 2005. Currently, the Company does not have any real estate transactions.

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Accordingly, adoption of SFAS 152 does not have a significant impact on our financial statements.

In December 2004, the FASB issued Statement No. 153 ("SFAS 153"), "Exchanges of Nonmonetary Assets - An Amendment of APB Opinion No. 29." SFAS 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Adoption of SFAS 153 does not have a significant impact on our financial statements.

In December 2004, the FASB issued Statement No. 123R ("SFAS 123R"), "Share-Based Payment." This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. It requires that the fair-value-based method be used to account for these transactions for all public entities. This Statement is effective for small

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### ALANCO TECHNOLOGIES, INC.

business issuers for the first reporting period after December 15, 2005, subject to additional extensions granted by the SEC, and will effect any stock-based compensation for options issued after that date, or not vested as of that date.

#### Note B - Inventories

Inventories have been recorded at the lower of cost or market. The composition of inventories as of March 31, 2005 and June 30, 2004 are summarized as follows:

	March 31, 2005	June 30, 2004
	-----	-----
	(unaudited)	
Raw materials and purchased parts	\$ 2,257,300	\$ 1,894,700
Work-in-progress	140,300	198,300
Finished goods	184,000	279,300
	-----	-----
	2,581,600	2,372,300
Less reserves for obsolescence	(324,000)	(90,000)
	-----	-----
	\$ 2,257,600	\$ 2,282,300
	=====	=====

#### Note C - Contracts In Process

Costs incurred, estimated earnings and billings in the RFID Technology segment, related to contracts for the installation of TSI PRISM system in process at March 31, 2005 and June 30, 2004 consist of the following:

	March 31, 2005	June 30, 2004
	-----	-----
	(unaudited)	
Costs incurred on uncompleted contracts	\$ 252,200	\$ 117,300
Estimated gross profit earned to date	162,800	58,200

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Revenue earned to date	415,000	175,500
Less Billing to date	(415,000)	(201,300)
-----		
Costs and estimated earnings in excess of Billing (billing in excess of costs and earnings)	\$ -	\$ (25,800)
	=====	=====

Note D - Deferred Revenue

Deferred Revenues at March 31, 2005 and June 30, 2004 consist of the following:

	March 31, 2005	June 30, 2004
	-----	-----
	(unaudited)	
Extended warranty revenue	\$ 105,200	\$ 27,200
Less - current portion	(105,200)	(27,200)
	-----	-----
Deferred revenue - long term	\$ -	\$ -
	=====	=====

ALANCO TECHNOLOGIES, INC.

Note E - New Commitments

During March 2005, the Company entered into a technology license agreement ("License") with AeroScout, Inc., a San Mateo, California based company ("AeroScout"), a developer of RFID real-time location services technology utilizing 2.4 GHz wireless networking standards (the "RTLS Technology"). The License grants to Alanco an exclusive five-year worldwide license for the corrections market, to acquire, modify or combine the AeroScout 2.4 GHz technology with Alanco's TSI PRISM technology. The License requires royalty payments to AeroScout for units sold, prepayment of \$180,000 (nonrefundable) to be paid over an eight-month period during fiscal year ending June 30, 2006 that may be applied to royalties and inventory purchases through the second year of the License, and minimum annual purchase requirements starting in the second year of the License. If these minimum requirements are not met, the Company may forfeit the right to the exclusive world-wide license.

Note F - Loss Per Share

Basic loss per share of common stock was computed by dividing net loss by the weighted average number of shares of common stock outstanding.

Diluted earnings per share are computed based on the weighted average number of shares of common stock and dilutive securities outstanding during the period. Dilutive securities are options and warrants that are freely exercisable into common stock at less than the prevailing market price. Dilutive securities are not included in the weighted average number of shares when inclusion would increase the earnings per share or decrease the loss per share. As of March 31, 2005 there were 3,803,750 potentially dilutive securities outstanding.

Note G - Equity

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During the nine months ended March 31, 2005, the Company issued a total of 2,762,600 shares of the Company's Class A Common Stock. Included were 2,438,200 shares issued upon exercise of outstanding warrants and options generating \$1,333,100 in proceeds to the Company and 74,400 shares, valued at fair market value on date of issue of \$73,300, in exchange for services rendered to the Company. The remaining 250,000 shares were issued as a prepayment for royalty payments and inventory purchases pursuant to minimum purchase requirements under a technology licensing agreement. The prepayment value for the 250,000 shares issued will be determined as market value on the effective date of the registration statement registering the shares. At March 31, 2005, the shares are valued, due to the lack of registration, at 90% of the March 31, 2005 market value, or \$213,300.

The Company granted five-year warrants to purchase 500,000 shares of the Company's Class A Common Stock at a strike price of \$1.00 per share in conjunction with the execution of a five-year technology licensing agreement and issued 75,000 five-year warrants at \$.90 per share relating to amending the Company's line of credit agreement. The warrants are valued under the Black-Scholes pricing model at approximately \$50,000 and \$23,000, respectively. The value for the warrant granted in conjunction with the execution of a five-year technology licensing agreement is recorded as technology licensing cost and is being amortized over a five-year period of the license agreement. The value of the warrant granted relating to amending the Company's line of credit agreement is being amortized over the term of the amended line of credit agreement.

The Company declared dividends on the Company's preferred shares during the nine months and paid the dividends-in-kind through the issuance of 304,400 shares of Series A Preferred Stock valued at \$453,700 and 4,800 shares of Series B Preferred Stock valued at \$46,100. The Preferred Stocks are more fully discussed in the Form-10KSB for the year ended June 30, 2004.

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### ALANCO TECHNOLOGIES, INC.

#### Note H -Industry Segment Data

Information concerning operations by industry segment follows (unaudited):

	Nine Months 2005	Ended 03/31 2004	Three Months 2005	Ended 03/31 2004
	-----	-----	-----	-----
Revenue				
Data Storage	\$ 4,638,200	\$ 3,335,600	\$ 1,450,700	\$ 1,088,900
RFID Technology	715,700	157,000	80,500	132,200
	-----	-----	-----	-----
Total Revenue	5,353,900	3,492,600	1,531,200	1,221,100
	=====	=====	=====	=====
Gross Profit				
Data Storage	1,579,400	1,227,700	532,400	363,800
RFID Technology	281,000	84,300	23,500	77,300
	-----	-----	-----	-----
Total Gross Profit	1,860,400	1,312,000	555,900	441,100
	-----	-----	-----	-----
Gross Margin				
Data Storage	34.1%	36.8%	36.7%	33.4%

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RFID Technology	39.3%	53.7%	29.2%	58.5%
Overall Gross Margin	34.7%	37.6%	36.3%	36.1%
Selling, General and Administrative Expense				
Data Storage	1,351,700	1,222,700	473,100	398,100
RFID Technology	2,069,200	1,521,900	675,300	523,100
Total Segment Operating Expense	3,420,900	2,744,600	1,148,400	921,200
Operating Profit (Loss)				
Data Storage	227,700	5,000	59,300	(34,300)
RFID Technology	(1,788,200)	(1,437,600)	(651,800)	(445,800)
Corporate Expense, net	(1,358,900)	(701,300)	(563,800)	(252,500)
Operating Loss	\$ (2,919,400)	\$ (2,133,900)	\$ (1,156,300)	\$ (732,600)
Depreciation and Amortization				
Data Storage	14,500	22,800	6,500	20,100
RFID Technology	240,500	230,600	81,800	73,600
Corporate	2,300	4,200	900	2,100
Total Depreciation and Amortization	\$ 257,300	\$ 257,600	\$ 89,200	\$ 95,800

Note I - Related Party Transactions

The Company has a \$1.3 million line of credit agreement ("Agreement"), more fully discussed in the Company's Form 10-KSB for the year ended June 30, 2004, with a private trust controlled by Mr. Donald Anderson, a greater than five percent stockholder and a member of the Company's Board of Directors. During the quarter ended March 31, 2005, the Agreement was amended and the expiration date of the Agreement was extended to July 1, 2007. In consideration for amending the Agreement, the Company granted the lender a five-year warrant to purchase 75,000 shares of the Company's Class A Common Stock at a purchase price of \$.90 per share.

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ALANCO TECHNOLOGIES, INC.

Note J - Line of Credit

At March 31, 2005, the Company had an outstanding balance of \$500,000, which is presented as Notes Payable. The balance is under a \$1.3 million line of credit agreement with a private trust ("Lender"), entered into in June 2002 and modified in April and October of 2003, and March 2005. Under the Agreement, the Company must maintain a minimum balance due under the line of at least \$500,000 through the July 1, 2007 expiration date. At March 31, 2005, the Company had \$800,000 available under the line of credit agreement.

Note K - Litigation

The Company continues to be a defendant in litigation that relates to the acquisition, in May of 2002, of substantially all the assets of Technology Systems International, Inc., a Nevada corporation. No significant new activity

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has occurred subsequent to our report of litigation in our Form 10-KSB filed for the year ended June 30, 2004. Due to internal governance issues affecting the plaintiff, the litigation has been indefinitely stayed. The Company's management, in consultation with legal counsel, believes the plaintiff's claims are without merit and the Company will aggressively defend against the action. Litigation previously reported as arising from an expired property lease between the Company's subsidiary, Arraid, Inc., and Arraid Property L.L.C., a Limited Liability Company, has been deemed immaterial. The Company intends to pursue legal expense reimbursement from both the Company's insurance carrier and the Plaintiffs in the litigation matters.

### Note L - Subsequent Events

In April 2005 the Company announced it had been awarded a contract to develop and provide modified TSI PRISM inmate tracking technology for a prison pilot project in Europe that requires a wireless system transmitting over the European-approved 2.4 GHz band rather than the 900 MHz band utilized in Alanco's U.S.A. TSI PRISM installations. The project will utilize technology that combines TSI PRISM and AeroScout WiFi-based Real Time Locating Services ("RTL") technologies. The European project marks the start of a formal partnership agreement between Alanco and AeroScout for Wi-Fi-based location and tracking solutions that meet the unique needs of the corrections market. The Company had entered into a technology agreement in March of 2005 that granted Alanco exclusive worldwide rights to distribute and create solutions based on AeroScout RTL technology for the corrections market.

The Company, in May of 2005, elected to modify the exercise price of warrants granted to four institutional investors to purchase a total of 700,000 shares of the Company's Class A Common Stock. The warrants were granted in conjunction with a private placement completed in April 2004. The warrants will expire on June 30, 2005 and were issued with an exercise price of \$1.60. The exercise price of the warrants was modified to a formula basis as follows:

The exercise price shall be determined as 90% of the average closing price for the ten (10) trading days prior to exercise of the warrant, excluding the date of exercise, with a maximum exercise price of \$1.60 and a minimum exercise price of \$1.10.

The expiration date of the warrants remains June 30, 2005.

### Item 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for historical information, the statements contained herein are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied by those

statements. These risks and uncertainties include, but are not limited to, the following factors: general economic and market conditions; reduced demand for information technology equipment; competitive pricing and difficulty managing product costs; development of new technologies which make the Company's products obsolete; rapid industry changes; failure by the Company's suppliers to meet quality or delivery requirements; the inability to attract, hire and retain key personnel; failure of an acquired business to further the Company's strategies; the difficulty of integrating an acquired business; undetected problems in the

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Company's products; the failure of the Company's intellectual property to be adequately protected; unforeseen litigation; the ability to maintain sufficient liquidity in order to support operations; the ability to maintain satisfactory relationships with lenders and to remain in compliance with financial loan covenants and other requirements under current banking agreements; and the ability to maintain satisfactory relationships with suppliers and customers.

### General

Information on industry segments is incorporated by reference from Note H - Segment Reporting to the Condensed Consolidated Financial Statements.

### Critical Accounting Policies and Estimates

Management's discussion and analysis of financial condition and results of operations are based upon the condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our financial statements requires the use of estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. On an ongoing basis, estimates are revalued, including those related to areas that require a significant level of judgment or are otherwise subject to an inherent degree of uncertainty. These areas include allowances for doubtful accounts, inventory valuations, carrying value of goodwill and intangible assets, estimated profit on uncompleted contracts in process, income and expense recognition, income taxes, ongoing litigation, and commitments and contingencies. Our estimates are based upon historical experience, observance of trends in particular areas, information and/or valuations available from outside sources and on various other assumptions that we believe to be reasonable under the circumstances and which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual amounts may differ from these estimates under different assumptions and conditions.

Accounting policies are considered critical when they are significant and involve difficult, subjective or complex judgments or estimates. We considered the following to be critical accounting policies:

Principles of consolidation - The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

Revenue recognition - The Company recognizes revenue from the Data Storage Segment, net of anticipated returns, at the time products are shipped to customers, or at the time services are provided. Revenue from material long-term contracts (in excess of \$250,000 and over a 90-day completion period) in both the Data Storage Segment and the RFID Technology Segment are recognized on the percentage-of-completion method for individual contracts, commencing when significant costs are incurred and adequate estimates are verified for substantial portions of the contract to where experience is sufficient to estimate final results with reasonable accuracy. Revenues are recognized in the ratio that costs incurred bear to total estimated costs. Changes in job performance, estimated profitability and final contract settlements would result in revisions to cost and income, and are recognized in the period in which the revisions were determined. Contract costs include all direct materials, subcontracts, labor costs and those direct and indirect costs related to contract performance. General and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is accrued.

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### ALANCO TECHNOLOGIES, INC.

Long-lived assets and intangible assets - The Company reviews carrying values at least annually or whenever events or circumstances indicate the carrying values may not be recoverable through projected discounted cash flows.

#### Results of Operations

(A) Three months ended 03/31/05 versus 03/31/04

#### Sales

Consolidated sales for the quarter ended March 31, 2005 was \$1,531,200, compared to \$1,221,100 for the comparable quarter of the previous year, an increase of \$310,100, or 25.4%. The increase is attributed to sales increases in the Data Storage segment, which increased \$361,800 to \$1,450,700 in the current quarter from \$1,088,900 reported for the three months ended March 31, 2004. The RFID Technology segment reported a sales decrease to \$80,500 in the quarter ended March 31, 2005 compared to \$132,200 for the comparable quarter in the prior fiscal year. The increase in Data Storage segment sales compared to the previous year resulted from increased demand for the Company's data storage products as companies increased technology expenditures in reaction to improving economic conditions. Sales of the RFID Technology segment decreased due to a reduction in current contract in progress revenue resulting from the continued prison contract and funding postponements caused by fiscal budgetary constraints.

#### Gross Profit and Operating Expenses

Gross profit generated during the quarter amounted to \$555,900, an increase of \$114,800, or 26.0%, when compared to \$441,100 reported for the same quarter of the prior year. Gross margins increased from 36.1% for the quarter ended March 31, 2004 to 36.3% for the current quarter. The increase in gross margin resulted from a change in product mix to higher gross margin products in the Data Storage segment.

Selling, general and administrative expenses for the current quarter increased to \$1,712,200, a \$538,500 increase, or 45.9%, when compared to \$1,173,700 incurred in the comparable quarter of fiscal year 2004. The major component of the increase in selling, general and administrative expense were increases of approximately \$265,000 in legal expense related to the litigation in which the Company is currently involved (See Litigation Footnote), increases in sales commissions related to Data Storage segment sales growth and increases in engineering salaries, R&D expenditures and marketing costs related to the RFID Technology segment's continued aggressive development in the core United States prison market, including the recently established lobbying activities in key states.

#### Operating Loss

The Operating Loss for the quarter was (\$1,156,300) compared to a loss of (\$732,600) for the same quarter of the prior year, an increase of 57.8%. The increased loss resulted primarily from increased legal expenses and increased development expenditures for the current quarter compared to the comparable quarter of the prior fiscal year in our RFID Technology segment.

#### Interest and Dividends Expense

Interest expense for the quarter amounted to \$11,200 compared to interest expense of \$21,500 for the same quarter in the prior year. The interest expense reduction resulted from a decrease in average borrowing during the quarter accomplished by the Company's effort in raising additional working capital. The Company paid quarterly in-kind Series B Preferred Stock dividends with values of \$252,000 and \$218,200 in the quarters ended March 31, 2005 and 2004, respectively.



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### Net Loss Attributable to Common Stockholders

Net Loss Attributable to Common Stockholders for the quarter ended March 31, 2005 amounted to (\$1,355,600), or (\$.05) per share, compared to a loss of (\$963,300), or (\$.05) per share, in the comparable quarter of the prior year. Although the Company has shown improved operating results in its Data Storage segment and anticipates improved future operating results in its RFID Technology segment as the economy improves, actual results in both the Data Storage segment and the RFID Technology segment may be affected by unfavorable economic

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### ALANCO TECHNOLOGIES, INC.

conditions and reduced capital spending budgets. If the economic conditions in the United States worsen or if a wider or global economic slowdown occurs, Alanco may experience a material adverse impact on its operating results and business conditions.

#### (B) Nine months ended 03/31/05 versus 03/31/04 Sales

Consolidated sales for the nine months ended March 31, 2005 was \$5,353,900, an increase of \$1,861,300, or 53.3%, compared to \$3,492,600 reported for the comparable period of the previous year. The increase is attributed to revenue increases in the Company's Data Storage segment which reported sales for the nine months of \$4,638,200, an increase of \$1,302,600, or 39.1%, compared to \$3,335,600 reported for the nine months ended March 31, 2004, and the RFID Technology segment, which reported nine months' sales of \$715,700 compared to \$157,000 for the comparable period in the prior fiscal year.

#### Gross Profit and Operating Expenses

Gross profit generated during the nine months amounted to \$1,860,400, an increase of \$548,400, or 41.8%, when compared to the \$1,312,000 reported for the same nine-month period of the prior year. Gross margins decreased from 37.6% for the nine months ended March 31, 2004 to 34.7% for the current period. The decrease in gross margin resulted primarily from a change in product mix to lower gross margin products in the Data Storage segment.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses for the nine months ended March 31, 2005 increased to \$4,779,800, a \$1,333,900 increase, or 38.7%, when compared to \$3,445,900 incurred in the comparable period of fiscal year 2004. The major components of the increase in selling, general and administrative expense were increases of approximately \$570,000 in legal expense related to the litigation in which the Company is currently involved (See Litigation Footnote), an increase in R&D expenditures of \$225,000 related to new technology in the RFID Technology segment that reduced the value of existing inventory, increases in sales commissions related to increases in Data Storage segment sales and RFID Technology segment's continued aggressive development in the core United States prison market, including the recently established lobbying activities in key states.

#### Operating Loss

The Operating Loss for the nine-month period was (\$2,919,400) compared to a loss of (\$2,133,900) for the same nine-month period of the prior fiscal year, an increase of 36.8%. The increased loss resulted primarily from increased legal expenses and R&D expenditures for the current period compared to the comparable nine-month period of the prior year.

#### Interest and Dividends Expense

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Interest expense for the nine months ended March 31, 2005 amounted to \$38,800 compared to interest expense of \$128,600 for the same nine-month period in the prior year. The reduction in interest expense resulted from a decrease in average borrowing during the period accomplished by the Company's successful effort in raising additional working capital. The Company paid in-kind Preferred Stock dividends with values of \$503,700 and \$245,200 in the nine months ended March 31, 2005 and 2004, respectively.

### Net Loss Attributable to Common Stockholders

Net Loss Attributable to Common Stockholders for the nine months ended March 31, 2005 amounted to (\$3,387,200), or (\$.13) per share, compared to a loss of (\$2,459,400), or (\$.15) per share, in the comparable period of the prior year. Although the Company has shown improved operating results in its Data Storage segment and anticipates improved future operating results in its RFID Technology segment as the economy improves, actual results in both the Data Storage segment and the RFID Technology segment may be affected by unfavorable economic conditions and reduced capital spending budgets. If the economic conditions in the United States worsen or if a wider or global economic slowdown occurs, Alanco may experience a material adverse impact on its operating results and business conditions.

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## ALANCO TECHNOLOGIES, INC.

### Liquidity and Capital Resources

The Company's current assets at March 31, 2005 exceeded current liabilities by \$2,712,100, resulting in a current ratio of 2.63 to 1. At June 30, 2004 the Company's current assets exceeded current liabilities by \$3,721,000, reflecting a current ratio of 3.85 to 1. The decrease in the current ratio at March 31, 2005 when compared to June 30, 2004 resulted from losses incurred during the period. Accounts receivable of \$1,053,500 at March 31, 2005, reflects an increase of \$396,300, or 60.3%, when compared to the \$657,200 reported as consolidated accounts receivable at June 30, 2004. The accounts receivable balance at March 31, 2005 represented fifty-three days' sales in receivables compared to fifty-one days' sales at June 30, 2004.

Consolidated inventories at March 31, 2005 amounted to \$2,257,600, a decrease of \$24,700, or 1%, when compared to \$2,282,300 at June 30, 2004. The March 31, 2005 reflects an inventory turnover of 2.1 compared to 1.3 at June 30, 2004. Although the March 31, 2005 balance reflects only a slight decrease from the June 30, 2004 balance, it is a much larger increase when compared to inventory levels of prior reporting periods and reflects management's continued anticipated revenue increases for both the Data Storage segment and the RFID Technology segment.

At March 31, 2005, the Company had an outstanding balance of \$500,000 under a \$1.3 million formula-based revolving bank line of credit agreement with interest calculated at prime plus 4%. The line of credit agreement formula is based upon current asset values and is used to finance working capital. At March 31, 2005, the Company had \$800,000 available under the line of credit. See Line of Credit Footnote J for additional discussion of the existing line of credit agreement.

Cash used in operations for the nine-month period was \$2,689,200, a decrease of \$167,400 when compared to cash used in operations of \$2,856,600 for the comparable period ended March 31, 2004. The decrease was due primarily to the stabilization in inventory values over the nine-month period ended March 31, 2005 when compared to the same period in the prior year, offset by an increase in loss from operations for the nine-month period.

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During the nine months ended March 31, 2005, the Company reported cash flows from investing activities of \$31,800, compared to \$248,100 reported for the nine months ended March 31, 2004. The reduction reflects the reduced collections of notes receivable balances and an increase in the purchase of property, plant and equipment, offset somewhat by the increase in net cash from discontinued operations.

Cash provided by financing activities for the nine months ended March 31, 2005 consisted primarily of \$1.3 million in net proceeds received from the sale of common stock. Cash provided by financing activities during the same period in the prior fiscal year included the collection of subscription receivables in the amount of \$899,200 and net proceeds from the sale of common and preferred stock of \$1,743,400, offset by net repayment on borrowings during the period of \$105,400.

The Company believes that additional cash resources may be required for working capital to achieve planned operating results for fiscal year 2006 and,

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ALANCO TECHNOLOGIES, INC.

if working capital requirements exceed current availability, the Company anticipates raising capital through additional borrowing, the exercise of stock options and warrants and/or the sale of stock in a private placement. The additional capital would supplement the projected cash flows from operations and the line of credit agreement in place at March 31, 2005. If additional working capital was required and the Company was unable to raise the required additional capital, it may materially affect the ability of the Company to achieve its financial plan. The Company has raised a significant amount of capital in the past and believes it has the ability, if needed, to raise the additional capital to fund the planned operating results for fiscal year 2006. See Footnote G - Equity for additional information related to working capital raised by the Company during the nine months ended March 31, 2005, necessary to achieve planned operating results for the current fiscal year results for fiscal year.

### Item 3 - CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the Securities and Exchange Commission (SEC), and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. Based on various evaluations of the Company's disclosure controls and procedures, some of which occurred during the 90 days prior to the filing date of this report, the Chief Executive and Chief Financial Officers believe that these controls and procedures are effective to ensure that the Company is able to collect, process and disclose the information it is required to disclose in the reports it files with the SEC within the required periods.

The Company also maintains a system of internal controls designed to provide reasonable assurance that: transactions are executed in accordance with management's general or specific authorization; transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles, and (2) to maintain accountability for assets. Access to assets is permitted only in accordance with management's general or specific authorization; and the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Since the date of the most recent evaluation of the Company's internal

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controls by the Chief Executive and Chief Financial Officers, there have been no significant changes in such controls or in other factors that could have significantly affected those controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

### PART II. OTHER INFORMATION

#### Item 1. LEGAL PROCEEDINGS

The Company continues to be a defendant in litigation that relates to the acquisition, in May of 2002, of substantially all the assets of Technology Systems International, Inc., a Nevada corporation. No significant new activity has occurred subsequent to our report of litigation in our Form 10-KSB filed for the year ended June 30, 2004. Due to internal governance issues affecting the plaintiff, the litigation has been indefinitely stayed. The Company's management, in consultation with legal counsel, believes the plaintiff's claims are without merit and the Company will aggressively defend the actions. Litigation previously reported as arising from an expired property lease between the Company's subsidiary, Arraid, Inc. and Arraid Property L.L.C., a Limited Liability Company, has been deemed immaterial. The Company intends to pursue legal expense reimbursement from both the Company's insurance carrier and the Plaintiffs in the litigation matters.

#### Item 2. CHANGES IN SECURITIES

During the nine months ended March 31, 2005, the Company issued 304,400 shares of Series A Preferred Stock and 4,800 Shares of Series B Preferred Stock as dividend in-kind payments, 2,438,200 shares of Class A Common Stock for the exercise of existing warrants and options and 324,400 shares of Common Stock for services rendered.

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ALANCO TECHNOLOGIES, INC.

#### Item 6. EXHIBITS

- 31.1 Certification of Chief Executive Officer
- 31.2 Certification of Chief Financial Officer
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer

#### SIGNATURE

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 thereunder duly authorized.

ALANCO TECHNOLOGIES, INC.  
(Registrant)

/s/ John A. Carlson

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John A. Carlson  
Executive Vice President and  
Chief Financial Officer

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ALANCO TECHNOLOGIES, INC.

EXHIBIT 31.1

Certification of  
Chairman and Chief Executive Officer  
of Alanco Technologies, Inc.

I, Robert R. Kauffman, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Alanco Technologies, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 16, 2005

/s/ Robert R. Kauffman

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Robert R. Kauffman  
Chairman and Chief Executive Officer

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ALANCO TECHNOLOGIES, INC.

EXHIBIT 31.2

Certification of  
Vice President and Chief Financial Officer  
of Alanco Technologies, Inc.

I, John A. Carlson, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Alanco Technologies, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

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(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 16, 2005

/s/ John A. Carlson

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John A. Carlson  
Executive Vice President and Chief Financial Officer

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ALANCO TECHNOLOGIES, INC.

EXHIBIT 32.1

Certification of  
Chief Executive Officer and Chief Financial Officer  
of Alanco Technologies, Inc.

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and accompanies this quarterly report of Form 10-QSB (the "Report") for the period ended March 31, 2005 of Alanco Technologies, Inc. (the "Issuer").

Each of the undersigned, who are the Chief Executive Officer and Chief Financial Officer, respectively, of Alanco Technologies, Inc., hereby certify that, to the best of each such officer's knowledge:

(i) the Report fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)); and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Issuer.

Dated: May 16, 2005

/s/ Robert R. Kauffman

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Robert R. Kauffman  
Chief Executive Officer

/s/ John A. Carlson

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John A. Carlson  
Chief Financial Officer