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ALANCO TECHNOLOGIES INC
Form 10QSB
November 14, 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 SECURITIE

EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2005

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

For the transition period from _____ to _____

Commission file number 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 November 4, 2005 there were 27,485,200 shares, net of treasury shares, of common stock outstanding.

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

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 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

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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 SEPTEMBER 30, 2005 AND JUNE 30, 2005

| | Sep. 30, 2005 | June 30, 2005 |
|---|---------------|---------------|
| | ----- | ----- |
| | (unaudited) | |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 351,200 | \$ 737,300 |
| Accounts receivable, net | 1,130,800 | 1,091,400 |
| Notes receivable, current | 29,600 | 80,000 |
| Inventories, net | 2,264,300 | 1,902,600 |
| Prepaid expenses and other current assets | 412,800 | 378,200 |
| | ----- | ----- |
| Total current assets | 4,188,700 | 4,189,500 |
| | ----- | ----- |
| PROPERTY, PLANT AND EQUIPMENT, NET | 286,200 | 273,500 |
| | ----- | ----- |
| OTHER ASSETS | | |
| Goodwill, net | 5,356,300 | 5,356,300 |
| Other intangible assets | 505,300 | 560,700 |
| Long-term notes receivable, net | 6,500 | 8,000 |
| Net assets held for sale | 85,000 | 100,200 |
| Other assets | 53,000 | 55,700 |
| | ----- | ----- |
| Total other assets | 6,006,100 | 6,080,900 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 10,481,000 | \$ 10,543,900 |
| | ===== | ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable and accrued expenses | \$ 1,580,300 | \$ 1,279,600 |
| Billings in excess of cost and est earnings on uncompleted contracts | 3,000 | 4,200 |
| Deferred revenue, current | 15,000 | 60,100 |
| | ----- | ----- |
| Total Current Liabilities | 1,598,300 | 1,343,900 |
| | ----- | ----- |
| LONG TERM LIABILITIES | | |
| Notes payable, long term | 1,314,100 | 1,143,600 |
| | ----- | ----- |
| TOTAL LIABILITIES | 2,912,400 | 2,487,500 |
| | ----- | ----- |
| Preferred Stock - Series B, 69,700 and 68,000 shares issued and outstanding, respectively | 684,200 | 667,300 |
| | ----- | ----- |
| SHAREHOLDERS' EQUITY | | |
| Preferred Stock - Series A Convertible, 2,947,100 and 2,781,200 shares issued and outstanding, respectively | 3,661,500 | 3,412,700 |
| Common Stock- 27,485,200 and 26,680,200 shares outstanding, net of 500,000 | | |

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| | | |
|--|---------------|---------------|
| shares of Treasury Stock | 72,291,100 | 71,714,600 |
| Treasury Stock, at cost | (375,100) | (375,100) |
| Accumulated deficit | (68,693,100) | (67,363,100) |
| | ----- | ----- |
| Total shareholders' equity | 6,884,400 | 7,389,100 |
| | ----- | ----- |
| TOTAL LIABILITIES & SHAREHOLDERS' EQUITY | \$ 10,481,000 | \$ 10,543,900 |
| | ===== | ===== |

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 SEPTEMBER 30, (Unaudited)

| | 2005 | 2004 |
|--|----------------|----------------|
| | ----- | ----- |
| NET SALES | \$ 1,601,600 | \$ 1,737,200 |
| Cost of goods sold | 1,056,700 | 1,115,800 |
| | ----- | ----- |
| GROSS PROFIT | 544,900 | 621,400 |
| Selling, general and administrative expense | 1,597,100 | 1,518,700 |
| | ----- | ----- |
| OPERATING LOSS | (1,052,200) | (897,300) |
| OTHER INCOME & EXPENSES | | |
| Interest expense, net | (20,500) | (16,300) |
| Other income, net | 8,400 | 5,000 |
| | ----- | ----- |
| LOSS FROM OPERATIONS | (1,064,300) | (908,600) |
| Preferred stock dividends - paid in kind | (265,700) | (236,800) |
| | ----- | ----- |
| NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS | \$ (1,330,000) | \$ (1,145,400) |
| | ===== | ===== |
| NET LOSS PER SHARE - BASIC AND DILUTED | | |
| - Net loss attributable to common shareholders | \$ (0.05) | \$ (0.05) |
| | ===== | ===== |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING | 26,915,400 | 24,312,600 |
| | ===== | ===== |

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2005 (unaudited)

| | COMMON STOCK | | SERIES A PREFERRED STOCK | | TREASURY STOCK | |
|-----------------------------------|--------------|---------------|-----------------------------|--------------|----------------|--------------|
| | SHARES | AMOUNT | SHARES | AMOUNT | SHARES | AMOUNT |
| Balances, June 30, 2005 | 27,180,200 | \$ 71,714,600 | 2,781,200 | \$ 3,412,700 | 500,000 | \$ (375,100) |
| Exercise of options | 30,000 | 11,100 | - | - | - | - |
| Exercise of warrants | 700,000 | 560,000 | - | - | - | - |
| Shares issued for services | 75,000 | 51,100 | - | - | - | - |
| Quarterly stock valuation | - | (45,700) | - | - | - | - |
| Preferred dividends, paid in kind | - | - | 165,900 | 248,800 | - | - |
| Net loss | - | - | - | - | - | - |
| Balances, September 30, 2005 | 27,985,200 | \$ 72,291,100 | 2,947,100 | \$ 3,661,500 | 500,000 | \$ (375,100) |

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ALANCO TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED SEPTEMBER 30,
(Unaudited)

| | 2005 | 2004 |
|---|----------------|--------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Loss from operations | \$ (1,064,300) | \$ (908,700) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 92,500 | 82,800 |
| Stock issued for services | - | 59,900 |
| Income from assets held for sale | (8,400) | (5,000) |
| Changes in: | | |
| Accounts receivable, net | (39,400) | (182,200) |
| Inventories, net | (361,700) | (55,000) |
| Costs in excess of billings and estimated earnings on uncompleted contracts | - | (21,600) |
| Prepaid expenses and other current assets | (29,300) | (51,600) |
| Accounts payable and accrued expenses | 300,700 | 209,700 |
| Deferred revenue | (45,100) | (27,200) |
| Billings and estimated earnings in excess of costs on uncompleted contracts | (1,200) | (25,800) |
| Other assets | 2,800 | 5,200 |
| Net cash used in operating activities | (1,153,400) | (919,500) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |

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| | | |
|---|----------|----------|
| Net cash from assets held for sale | 23,600 | 19,100 |
| Collection of notes receivable, net | 51,900 | 30,000 |
| Purchase of property, plant and equipment | (49,800) | (34,000) |
| Patent renewal and other | - | (1,900) |
| | ----- | ----- |
| Net cash provided by investing activities | 25,700 | 13,200 |
| | ----- | ----- |

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
FOR THE THREE MONTHS ENDED SEPTEMBER 30, (Continued)

| | 2005 | 2004 |
|--|-------------|--------------|
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Advances on borrowings | \$ 170,500 | \$ - |
| Repayment on borrowings | - | (3,000) |
| Net proceeds from equity transactions | 571,100 | 1,100,100 |
| | ----- | ----- |
| Net cash provided by financing activities | 741,600 | 1,097,100 |
| | ----- | ----- |
| NET INCREASE (DECREASE) IN CASH | (386,100) | 190,800 |
| CASH AND CASH EQUIVALENTS, beginning of period | 737,300 | 1,975,600 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS, end of period | \$ 351,200 | \$ 2,166,400 |
| | ===== | ===== |
| SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION | | |
| Net cash paid during the period for interest | \$ 20,500 | \$ 16,700 |
| | ===== | ===== |
| Non-Cash Activities: | | |
| Value of stocks and warrants issued for services and prepayments | \$ 51,100 | \$ 59,900 |
| | ===== | ===== |
| Valuation adjustment | \$ (45,700) | \$ - |
| | ===== | ===== |
| Value of warrants issued for credit line extension | \$ - | \$ 23,300 |
| | ===== | ===== |
| Series B preferred stock dividend, paid in kind | \$ 16,900 | \$ 15,000 |
| | ===== | ===== |
| Series A preferred stock dividend, paid in kind | \$ 248,800 | \$ 221,800 |
| | ===== | ===== |

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See accompanying notes to the consolidated financial statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE PERIOD ENDED SEPTEMBER 30, 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 September 30, 2005, the related unaudited condensed consolidated statements of operations for the three months ended September 30, 2005 and the related unaudited condensed consolidated statement of cash flows for the three months ended September 30, 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, 2005, 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 three months ended September 30, 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 to the pro forma amounts presented below.

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| | 3 months ended September 30, | |
|--|------------------------------|----------------|
| | 2005 | 2004 |
| | ----- | ----- |
| Net loss, as reported | \$ (1,330,000) | \$ 1,145,400) |
| Deduct: Total stock-based Employee compensation expense determined under fair value based methods for all awards, net of related tax effects | \$ (358,900) | \$ (43,500) |
| | ----- | ----- |
| Pro forma net loss | \$ (1,688,900) | \$ (1,188,900) |
| | ===== | ===== |
| Net loss per common share, basic and diluted | | |
| As reported | \$ (0.05) | \$ (0.05) |
| | ===== | ===== |
| Pro forma | \$ (0.06) | \$ (0.05) |
| | ===== | ===== |
| Weighted Average Shares Outstanding, | | |
| Basic and Diluted | 26,915,400 | 24,312,600 |
| | ===== | ===== |
| Pro Forma Weighted Average Shares Outstanding, | | |
| Basic and Diluted | 26,970,100 | 24,332,200 |
| | ===== | ===== |

During the three months ended September 30, 2005, the Company granted employee stock options to purchase 1,435,000 shares of the Company's Class A Common Stock at an average purchase price of \$0.84, market price on date of grant. 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. 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

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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.

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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 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.

In May 2005, the FASB issued Statement No. 154 ("SFAS 154"), "Accounting Changes and Error Corrections." SFAS 154 replaces APB Opinion No. 20, ("APB 20") and SFAS No. 3 to require retrospective application of changes to all prior period financial statements so that those financial statements are presented as if the current accounting principle had always been applied. APB 20 previously required most voluntary changes in accounting principles to be recognized by including in net income of the period of change the cumulative effect of changing to the new accounting principle. In addition, SFAS 154 carries forward without change the guidance contained in APB 20 for reporting a correction of an error in previously issued financial statements and a change in accounting estimate. SFAS 154 is effective for changes and corrections made after January 1, 2006, with early adoption permitted. The Company is currently not contemplating changes that would be impacted by SFAS 154.

Note B - Inventories

Inventories are recorded at the lower of cost or market. The composition of inventories as of September 30, 2005 and June 30, 2005 are summarized as follows:

| | September 30, 2005 | June 30, 2005 |
|-----------------------------------|-----------------------|------------------|
| | ----- | ----- |
| | (unaudited) | |
| Raw materials and purchased parts | \$ 2,403,300 | \$ 2,011,900 |
| Work-in-progress | 91,700 | 106,000 |
| Finished goods | 99,200 | 99,300 |
| | ----- | ----- |
| | 2,594,200 | 2,217,200 |
| Less reserves for obsolescence | (329,900) | (314,600) |
| | ----- | ----- |
| | \$ 2,264,300 | \$ 1,902,600 |
| | ===== | ===== |

Note C - Contracts In Process

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

| | September 30, 2005 | June 30, 2005 |
|--|-----------------------|------------------|
| | ----- | ----- |
| | (unaudited) | |
| Costs incurred on uncompleted contracts | \$ 64,300 | \$ 34,100 |
| Estimated gross profit earned to date | 9,700 | 1,700 |
| | ----- | ----- |
| Revenue earned to date | 74,000 | 35,800 |
| Less Billing to date | (77,000) | (40,000) |
| | ----- | ----- |
| Billing in excess of costs and estimated earnings | \$ (3,000) | \$ (4,200) |
| | ===== | ===== |

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Note D - Deferred Revenue

Deferred Revenues at September 30, 2005 and June 30, 2005 consist of the following:

| | September 30, 2005 | June 30, 2005 |
|------------------------------|-----------------------|------------------|
| | ----- | ----- |
| | (unaudited) | |
| Extended warranty revenue | \$ 15,000 | \$ 60,100 |
| Less - current portion | (15,000) | (60,100) |
| | ----- | ----- |
| Deferred revenue - long term | \$ - | - |
| | ===== | ===== |

Note E - 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 September 30, 2005 there were 3,690,000 potentially dilutive securities outstanding.

Note F - Equity

During the three months ended September 30, 2005, the Company issued a total of 805,000 shares of the Company's Class A Common Stock. Included were 730,000 shares issued upon exercise of outstanding warrants and options

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generating \$571,100 in proceeds to the Company. In addition, the Company granted 75,000 shares, valued at fair market value on date of issue of \$51,100, in exchange for future services to be rendered to the Company.

During March 2005, the Company entered into a technology license agreement with a developer of RFID real-time location services technology utilizing 2.4 GHz wireless networking standards. In conjunction with the execution of the license agreement, the Company issued 250,000 shares of the Company's Class A Common Stock, the value of which may be applied to future royalty payments and inventory purchases. The definitive value for the 250,000 shares issued will be determined at market value on the effective date of the applicable stock registration statement; however, at September 30, 2005, the value of the issued shares was determined to be \$175,000, based upon the closing market price on September 30, 2005, of \$.70 per share. At June 30, 2005, the stock had been valued at \$220,700, resulting in a quarterly valuation reduction of \$45,700.

The Company modified, during the quarter ended September 30, 2005, the exercise price and expiration date 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 Company modified the exercise price from the formula base to \$.80 per share. The warrants were to expire on August 1, 2005, and were modified to expire on September 1, 2005. The warrants were exercised on August 31, 2005, resulting in net proceeds to the Company of \$560,000.

Subsequent to September 30, 2005, the Company reduced the exercise price from \$1.00 per share to \$.70 per share for warrants to purchase 1,450,000 shares of the Company's Class A Common Stock, granted to a group of equity investors in conjunction with a private placement in October 2002. The \$.70

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exercise price represented a value approximately three percent greater than market on the date the warrant strike price was modified. Warrants to purchase 600,000 (43%) of the 1,450,000 shares were held by officers and directors of the Company, including warrants to purchase 100,000 shares held by Robert R. Kauffman, CEO, Director and greater than five percent (5%) owner of the Company and warrants to purchase 400,000 shares controlled by Don Anderson, a Director and greater than five percent (5%) owner of the Company. The warrants expire on December 31, 2005.

The Company declared and paid dividends-in-kind on the Company's preferred shares through the issuance of 165,900 shares of Series A Preferred Stock valued at \$248,800 and 1,700 shares of Series B Preferred Stock valued at \$16,900. The Preferred Stocks are more fully discussed in the Form-10KSB for the year ended June 30, 2005.

Note G -Industry Segment Data

Information concerning operations by industry segment follows (unaudited):

| Three Months ended 09/30 | |
|--------------------------|-------|
| 2005 | 2004 |
| ----- | ----- |

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| | | |
|---|----------------|--------------|
| Revenue | | |
| Data Storage | \$ 1,464,600 | \$ 1,365,700 |
| RFID Technology | 137,000 | 371,500 |
| | ----- | ----- |
| Total Revenue | 1,601,600 | 1,737,200 |
| | ===== | ===== |
| | | |
| Gross Profit | | |
| Data Storage | 510,000 | 479,900 |
| RFID Technology | 34,900 | 141,500 |
| | ----- | ----- |
| Total Gross Profit | 544,900 | 621,400 |
| | ----- | ----- |
| | | |
| Gross Margin | | |
| Data Storage | 34.8% | 35.1% |
| | ----- | ----- |
| RFID Technology | 25.5% | 38.1% |
| | ----- | ----- |
| Overall Gross Margin | 34.0% | 35.8% |
| | ----- | ----- |
| | | |
| Selling, General and Administrative Expense | | |
| Data Storage | 562,100 | 445,200 |
| RFID Technology | 673,300 | 690,000 |
| | ----- | ----- |
| Total Segment Operating Expense | 1,235,400 | 1,135,200 |
| | ----- | ----- |
| | | |
| Operating Profit (Loss) | | |
| Data Storage | (52,100) | 34,700 |
| RFID Technology | (638,400) | (548,500) |
| Corporate Expense, net | (361,700) | (383,500) |
| | ----- | ----- |
| Operating Loss | \$ (1,052,200) | \$ (897,300) |
| | ===== | ===== |
| | | |
| Depreciation and Amortization | | |
| Data Storage | 6,100 | 3,600 |
| RFID Technology | 85,500 | 78,500 |
| Corporate | 900 | 700 |
| | ----- | ----- |
| Total Depreciation and Amortization | \$ 92,500 | \$ 82,800 |
| | ===== | ===== |

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ALANCO TECHNOLOGIES, INC.

Note H - Related Party Transactions

The Company has a \$1.5 million line of credit agreement ("Agreement"), more fully discussed in the Company's Form 10-KSB for the year ended June 30, 2005, 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. See Note - F Equity for discussion of modification to warrants granted to a group of equity investors, including entities Mr. Anderson controls.

Note I - Line of Credit

At September 30, 2005, the Company had an outstanding balance under the

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line of credit agreement of \$1,000,000. The balance is under a \$1.5 million line of credit agreement with a private trust ("Lender"), entered into in June 2002 and last modified on June 29, 2005. Under the Agreement, the Company must maintain a minimum balance due under the line of at least \$1,000,000 through the July 1, 2007 expiration date. As such, the \$1,000,000 due under the line of credit agreement is recorded as Notes payable, long term. At September 30, 2005, the Company had \$500,000 available under the line of credit agreement.

Note J - 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 has occurred subsequent to our report of litigation in our Form 10-KSB filed for the year ended June 30, 2005. 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.

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 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 G - 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

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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.

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 09/30/05 versus 09/30/04
Sales

Consolidated sales for the quarter ended September 30, 2005 was \$1,601,600, a decrease of \$135,600, or 7.8%, when compared to \$1,737,200 for the comparable quarter of the prior year. The decrease resulted from a sales decrease in the RFID Technology reporting segment of \$234,500, from \$371,500 for the quarter ended September 30, 2004 to \$137,000 for the current quarter. The Data Storage segment increased sales by 7.2%, to \$1,464,600 from \$1,365,700 reported for the quarter ended September 30, 2004. 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

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revenue resulting from the continued prison contract and funding postponements caused by fiscal budgetary constraints.

Gross Profit and Operating Expenses

Gross profit reported during the quarter amounted to \$544,900, a decrease of \$76,500, or 12.3%, when compared to \$621,400 reported for the same quarter of the prior year. The decrease in gross profit resulted from reduced sales of the RFID Technology segment. Consolidated gross margins decreased from

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35.8% for the quarter ended September 30, 2004 to 34.0% for the current quarter. The decrease in gross margin resulted from the minimal sales of the RFID Technology segment which distorts the gross margin percentage and a change in product mix in the Data Storage segment to lower gross margin products resulting in a gross margin reduction to 34.8% from 35.1% for the same quarter of the prior year.

Selling, general and administrative expenses for the current quarter increased to \$1,597,100, a \$78,400 increase, or 5.2%, when compared to \$1,518,700 incurred in the comparable quarter of fiscal year 2004. The major component of the increase was an increase of approximately \$117,000 in sales and administrative expenses related to Data Storage segment sales growth, offset by small reductions in selling, general and administrative expenses for the RFID Technology segment and a reduction of corporate expenses. The selling, general and administrative expenses reflected an increase in unallocated engineering project expenses of approximately \$45,000, increased sales and sales support expenses of approximately \$65,000.

Operating Loss

The Operating Loss for the quarter was (\$1,052,200) compared to a loss of (\$897,300) for the same quarter of the prior year, an increase of \$154,900, or 17.3%. The increased Operating Loss resulted from the RFID Technology segment increasing its Operating Loss to (\$638,400), an increase of \$89,900, or 16.4%, when compared to the Operating Loss reported in the same quarter of the prior year of (\$548,500), and from the Data Storage segment reporting a Operating Loss of (\$52,100), compared to an Operating profit of \$34,700 reported in the comparable quarter of the prior year.

Interest Expense, Other Income and Dividends Expense

Net interest expense for the quarter amounted to \$20,500 compared to interest expense of \$16,300 for the same quarter in the prior year. The interest expense increase resulted from increases in the prime rate, and an increase in the minimum borrowing limit of our credit line. Other Income increased to \$8,400 from \$5,000 reported for the comparable quarter of the prior year. The Company paid quarterly in-kind Series A and Series B Preferred Stock dividends with values of \$265,700 and \$236,800 in the quarters ended September 30, 2005 and 2004, respectively.

Net Loss Attributable to Common Stockholders

Net Loss Attributable to Common Stockholders for the quarter ended September 30, 2005 amounted to (\$1,330,000), or (\$.05) per share, compared to a loss of (\$1,145,400), or (\$.05) per share, in the comparable quarter of the prior year. Although the Company has reported increased operating losses in both the RFID Technology segment and its Data Storage segment, it anticipates improved future operating results in both segments as the economy improves. However, actual results in both the Data Storage segment and the RFID Technology segments may be affected by unfavorable economic conditions and reduced capital spending budgets. If the economic conditions in the United States worsen or if a

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wider or global economic slowdown occurs, Alanco may experience a material adverse impact on its operating results and business conditions.

Liquidity and Capital Resources

The Company's current assets at September 30, 2005 exceeded current liabilities by \$2,590,400, resulting in a current ratio of 2.62 to 1. At June 30, 2005 the Company's current assets exceeded current liabilities by \$2,845,600, reflecting a current ratio of 3.12 to 1. The decrease in the current ratio at September 30, 2005 when compared to June 30, 2005 resulted primarily

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from funding operating losses during the period. Accounts receivable of \$1,130,800 at September 30, 2005, reflects an increase of \$39,400, or 3.6%, when compared to the \$1,091,400 reported as consolidated accounts receivable at June 30, 2005. The accounts receivable balance at September 30, 2005 represented sixty-four days' sales in receivables compared to fifty-five days' sales at June 30, 2005.

Consolidated inventories at September 30, 2005 amounted to \$2,264,300, an increase of \$361,700, or 19.0%, when compared to \$1,902,600 at June 30, 2005. The September 30, 2005 reflects an inventory turnover of 1.9 compared to an inventory turnover of 3.8 reported at June 30, 2005. Although the September 30, 2005 inventory balance of \$2,264,300 reflects a significant increase from the inventory balance at June 30, 2005 of \$1,902,600, it reflects a slight decrease from the \$2,337,300 reported as of September 30, 2004. The current inventory levels reflect management's continued anticipated revenue increases for both the Data Storage segment and the RFID Technology segment.

At September 30, 2005, the Company had an outstanding balance of \$1,000,000 under a \$1.5 million formula-based revolving bank line of credit agreement with interest calculated at prime plus 2%. The line of credit agreement formula is based upon current asset values and is used to finance working capital. At September 30, 2005, the Company had \$500,000 available under the line of credit. See Line of Credit Footnote I for additional discussion of the existing line of credit agreement.

Cash used in operations for the three-month period ended September 30, 2005 was \$1,153,400, an increase of \$233,900 when compared to cash used in operations of \$919,500 for the comparable period ended September 30, 2004. The increase resulted primarily from increases in inventory levels during the current quarter, compared to an increase in inventory levels during the comparable quarter of the prior year, offset somewhat by increases in accounts payable and accrued expense that exceeded the increase in the quarter ended September 30, 2004.

During the three months ended September 30, 2005, the Company reported cash flows from investing activities of \$25,700, compared to \$13,200 reported for the three months ended September 30, 2004. The increase is primarily the result of collection of notes receivable.

Cash provided by financing activities for the three months ended September 30, 2005 consisted of \$571,100 in net proceeds received from the exercise of warrants and options, and \$170,500 borrowed against the credit line. Cash provided by financing activities during the same period in the prior fiscal year included the net proceeds from the sale of common and preferred stock of \$1,100,100, offset by net repayment on borrowings during the period of \$3,000.

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The Company believes that additional cash resources may be required for working capital to achieve planned operating results for fiscal year 2006 and, 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 September 30, 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 F - Equity for additional information related to working capital raised by the Company during the three months ended September 30, 2005, necessary to achieve planned operating results for the current fiscal year results.

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.

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Since the date of the most recent evaluation of the Company's internal 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, 2005. Due to internal governance issues affecting the plaintiff, the litigation has been indefinitely stayed. The Company's

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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 three months ended September 30, 2005, the Company issued 165,900 shares of Series A Preferred Stock and 1,700 Shares of Series B Preferred Stock as dividend in-kind payments, 730,000 shares of Class A Common Stock for the exercise of existing warrants and options and 75,000 shares of Common Stock for services rendered.

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
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;

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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: November 11, 2005

/s/ Robert R. Kauffman

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

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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: November 11, 2005
/s/ John A. Carlson

John A. Carlson
Executive Vice President and Chief Financial Officer

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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 September 30, 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: November 11, 2005

/s/ Robert R. Kauffman

Robert R. Kauffman
Chief Executive Officer

/s/ John A. Carlson

John A. Carlson
Chief Financial Officer