

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

ISLAND PACIFIC INC
Form 10-Q/A
November 16, 2004

=====

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A
(Amendment No. 2)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2003 OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission file number 0-23049

ISLAND PACIFIC, INC.

(Formerly, SVI Solutions, Inc.)

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE

33-0896617

(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

(I.R.S. EMPLOYER IDENTIFICATION NUMBER)

19800 MACARTHUR BOULEVARD, 12TH FLOOR, IRVINE, CALIFORNIA

92612

(Address of principal executive offices)

(Zip Code)

(949) 476-2212

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date. Common Stock, \$0.0001 Par Value - 50,551,943 shares as of February 5, 2004.

=====

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

EXPLANATORY NOTE

This quarterly report on Form 10-Q/A Amendment No. 2 is an amendment to the Form 10-Q/A Amendment No. 1 filed by the Company on June 30, 2004 for the quarter ended December 31, 2003.

This quarterly report on Form 10-Q/A Amendment No. 2 is being filed to reflect the restatement of the Registrant's Condensed Consolidated Financial Statements (the "Restatement"). The Restatement reflects the following:

1. Reversal of revenue recognized on an one-time sale of software technology rights,
2. Presentation of revenues and cost of revenues separately as product and services revenues and corresponding cost of revenues,
3. Reclassification of amortization expense of software products from depreciation and amortization expense to cost of product revenue,
4. Reversal of a purchase of software technology ("Software Technology")
5. Accrual of a royalty liability pursuant to the purchase agreement of Software Technology,
6. Capitalization of beneficial charges and amortization of these charges over the term of the debt,
7. Capitalization of legal fees related to the acquisitions of Page Digital Incorporated, and
8. Restatements made in prior periods.

The Company will not file an amended Form 10-K/A for the year ended March 31, 2003 due to the immateriality of adjustments. However, certain disclosures that relate to and appear in Form 10-K/A for the year ended March 31, 2003 have been updated in the restated filings.

THIS REPORT DOES NOT OTHERWISE ATTEMPT TO UPDATE THE INFORMATION PROVIDED HEREIN BEYOND THE ORIGINAL FILING DATE.

TABLE OF CONTENTS

	PAGE

PART I. - FINANCIAL INFORMATION	
Item 1. Condensed Consolidated Financial Statements	
Condensed Consolidated Balance Sheets as of December 31, 2003 (as restated) and March 31, 2003	3
Condensed Consolidated Statements of Operations for the Three Months and Nine Months Ended December 31, 2003 and 2002 (as restated).....	4
Condensed Consolidated Statements of Cash Flows for the Nine Months Ended December 31, 2003 and 2002 (as restated).....	5
Notes to Condensed Consolidated Financial Statements	6

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

Item 2. Management's Discussion and Analysis of Financial Condition
and Results of Operations.....14

Item 3. Quantitative and Qualitative Disclosures About Market Risk.....32

Item 4. Controls and Procedures.....32

PART II. - OTHER INFORMATION

Item 1. Legal Proceedings.....33

Item 2. Changes in Securities and Use of Proceeds.....33

Item 3. Defaults Upon Senior Securities.....33

Item 4. Submission of Matters to a Vote of Security Holders.....33

Item 5. Other Information.....33

Item 6. Exhibits and Reports on Form 8-K.....34

SIGNATURES.....36

CERTIFICATIONS.....37

PART I. - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ISLAND PACIFIC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	DECEMBER 31, 2003

	(As restated- See Note 16)
ASSETS	
Current assets:	
Cash and cash equivalents	\$ 5,131
Accounts receivable, net of allowance for doubtful accounts of \$260 and \$372, respectively	5,262
Other receivables, including \$0 and \$3 from related parties, respectively	113
Inventories	84
Current portion of non-compete agreements	748
Net assets from discontinued operations	--
Prepaid expenses and other current assets	1,205

Total current assets	12,543
Note receivable	162

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

Property and equipment, net	367
Purchased and capitalized software, net	15,954
Goodwill, net	14,795
Non-compete agreements, net	149
Other assets	349

Total assets	\$ 44,319
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Debt due to stockholders	\$ --
Convertible note	500
Current portion of long-term debts	--
Accounts payable	667
Accrued expenses	2,694
Deferred revenue	3,242
Income tax payable	64

Total current liabilities	7,167
Convertible debentures, net of debt discount of \$0 and \$1,340, respectively	--
Other long-term liabilities	275

Total liabilities	7,442

Commitments and contingencies	
Stockholders' equity:	
Preferred Stock, \$.0001 par value; 5,000,000 shares authorized; Series A Convertible Preferred, 7.2% cumulative 141,100 shares authorized and outstanding with a stated value of \$100 per share, dividends in arrears of \$1,716 and \$1,269, respectively	14,100
Committed common stock - 2,500,000 shares	--
Common stock, \$.0001 par value; 100,000,000 shares authorized; 47,681,344 and 42,199,632 shares issued; and 47,681,344 and 31,499,632 shares outstanding, respectively	5
Additional paid in capital	67,927
Accumulated deficit	(45,155)
Treasury stock, at cost; shares - 10,700,000	--

Total stockholders' equity	36,877

Total liabilities and stockholders' equity	\$ 44,319
	=====

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

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

(in thousands, except per share data)

	Three Months Ended December 31,	
	2003	2002
	(As restated - See Note 16)	
Revenues:		
Product	\$ 4,207	\$ 4,083
Services	683	3,035
	4,890	7,118
Total revenues		
Cost of revenues:		
Product	1,627	1,159
Services	434	1,739
	2,061	2,898
Total cost of revenues		
Gross profit	2,829	4,220
Expenses:		
Application development	361	650
Depreciation and amortization	272	315
Selling, general and administrative	2,808	2,671
	3,441	3,636
Total expenses		
Income (loss) from operations	(612)	584
Other income (expense):		
Interest income	7	--
Other income (expense)	112	15
Interest expense	--	(209)
	119	(194)
Total other income (expenses)		
Income (loss) before provision for income taxes	(493)	390
Provision for income tax benefits	(19)	(1)
	(474)	391
Income (loss) before cumulative effect of a change in accounting principle		
Cumulative effect of changing accounting principle - goodwill valuation under SFAS 142	--	--
	(474)	391
Income (loss) from continuing operations	(474)	391
Income (loss) from discontinued operations of the SVI Training Products Inc, subsidiary, net of applicable income taxes	--	(7)
	(474)	384
Net income (loss)		
Cumulative preferred dividends	(184)	(253)
	\$ (658)	\$ 131
Net income (loss) available to common stockholders		
Basic earnings (loss) per share:		
Income (loss) before cumulative effect of a change in accounting principle	\$ (0.01)	\$ 0.01
Cumulative effect of a change in accounting principle - goodwill Valuation under SFAS 142	--	--
	(0.01)	0.01
Income (loss) from continuing operations		

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

Income from discontinued operations	--	--
Cumulative preferred dividends	--	(0.01)
	-----	-----
Net income (loss) available to common stockholders	\$ (0.01)	\$ --
	=====	=====
Diluted earnings (loss) per share:		
Income (loss) before cumulative effect of a change in accounting principle	\$ (0.01)	\$ 0.01
Cumulative effect of a change in accounting principle - goodwill valuation under SFAS 142	--	--
	-----	-----
Income (loss) from continuing operations	(0.01)	0.01
Income from discontinued operations	--	--
Cumulative preferred dividends	--	(0.01)
	-----	-----
Net income (loss) available to common stockholders	\$ (0.01)	\$ --
	=====	=====
Weighted-average common shares outstanding:		
Basic	46,172	30,395
Diluted	46,172	58,734

The accompanying notes are an integral part of these condensed consolidated financial

4

ISLAND PACIFIC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	NINE MONTHS 2003 -----
	(As restated)
Cash flows from operating activities:	
Net loss	\$ (4,665)
Adjustments to reconcile net loss to net cash used for operating activities:	
Depreciation and amortization	2,688
Cumulative effect of a change in accounting principle - goodwill valuation under SFAS 142	--
Gain on disposal of furniture and equipment	169
Amortization of debt discount and conversion option	1,542
Changes in allowance for doubtful accounts	(112)
Stock-based compensation	195
Common stock issued for services rendered and settlement cost	385
Changes in assets and liabilities net of effects from acquisitions:	
Accounts receivable and other receivables	(2,575)
Inventories	7
Prepaid expenses and other assets	(1,270)
Accounts payable and accrued expenses	(3,691)
Income tax payable	64
Accrued interest on stockholders' loans, convertible notes and term loan	187

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

Deferred revenue	1,682
Net cash used for operating activities	(5,394)
Cash flows from investing activities:	
Proceeds received from note receivable	18
Purchases of furniture and equipment	(301)
Capitalized software development costs	(3,002)
Net cash used for investing activities	(3,285)
Cash flows from financing activities:	
Sale of common stock, net of offering costs	11,929
Decrease in amount due to stockholders, net	--
Proceeds from convertible debt	700
Payments on term loan and debentures	(135)
Proceeds from short-term loan from related party	--
Payments on short-term loan from related party	--
Net cash provided by financing activities	12,494
Effect of exchange rate changes on cash	(3)
Net increase (decrease) in cash and cash equivalents	3,812
Cash and cash equivalents, beginning of period	1,319
Cash and cash equivalents, end of period	\$ 5,131
Supplemental disclosure of cash flow information:	
Interest paid	\$ 135
Supplemental schedule of non-cash investing and financing activities:	
Issued 4,103,161 shares of common stock upon conversion of the 9% debentures	\$ 4,200
Repaid a convertible note by offsetting against outstanding account receivable	\$ 1,382
Issued 2,287,653 shares of common stock upon conversion of the note due to stockholders	\$ 1,374
Issued 500,000 shares of common stock as payment for dividend on preferred stock	\$ 421
Retired 10,700,000 shares of treasury stock	\$ (8,906)
Issued 1,010,000 shares of common stock to repay in full a stockholder's note	\$ --
Issued 231,021 shares of common stock upon exercise of stock options	\$ 1
Issued 100,000 shares of common stock for services in connection with an equity financing in December 2000	--
Issued 140,000 shares of common stock to pay for penalty for late effectiveness of the registration statement	--
Received 262,500 shares of common stock related to early termination of a service contract	--
Issued 84,849 and 1,223,580 shares of common stock as payments for bonuses and services rendered in prior periods	\$ 83

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

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

ISLAND PACIFIC, INC. AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND BASIS OF PREPARATION

The accompanying unaudited condensed consolidated financial statements (as restated) have been prepared in accordance with generally accepted accounting principles applicable to interim financial statements. Accordingly, they do not include all of the information and notes required for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the financial position, results of operations and cash flows at December 31, 2003 and for all the periods presented have been made.

Certain amounts in the prior periods have been reclassified to conform to the presentation for the three and nine months ended December 31, 2003. The financial information included in this quarterly report should be read in conjunction with the consolidated financial statements and related notes thereto in our Form 10-K/A for the year ended March 31, 2003.

The results of operations for the three and nine months ended December 31, 2003 and 2002 are not necessarily indicative of the results to be expected for the full year.

NOTE 2 - DISCONTINUED OPERATIONS

Effective April 1, 2003, we sold our wholly-owned subsidiary, SVI Training Products, Inc. ("Training Products"), to its former president, for the sale price of \$180,000 plus earn-out payments equal to 20% of the total gross revenues of Training Products in each of its next two fiscal years, to the extent the revenues in each of those years exceed certain targets. We received a promissory note for the amount of \$180,000 and the earn-out payments, if any, will be made in quarterly installments following each fiscal year, bearing an annual interest rate of 5%. We agreed to postpone the payments due January 1, 2004 and April 1, 2004 until July 1, 2004. The note has a balance of \$162,000 at December 31, 2003.

The sale of the Training Products subsidiary resulted in a loss of \$129,000, net of estimated income taxes, which was accrued for at March 31, 2003. Accordingly, the operating results of the Training Products subsidiary for the three and nine months ended December 31, 2002 were restated as discontinued operations.

NOTE 3 - INVENTORIES

Inventories consist of finished goods and are stated at the lower of cost or market, on a first-in, first-out basis.

NOTE 4 - PURCHASED AND CAPITALIZED SOFTWARE (AS RESTATED)

In September 2003, we signed a Source Code License and Private Label agreement with QQQ Systems Pty Limited ("QQQ") for the sale of software technology rights and exclusivity to use our Host Retail Merchandising Software (our core product) and Direct Software (Market Place System) for the Australasia market. Our management at the time did not see the Australasia market as a viable market for our products and therefore decided to sell the license rights to that market. We recorded this as revenues and an account receivable in the quarter ended September 30, 2003 as a persuasive evidence of an arrangement existed, the software had been delivered to and accepted by QQQ, the price was fixed and collectibility was reasonably assured. The total license fee was \$3.9 million and was to be paid \$1.95 million on November 15, 2003 and \$1.95 million on

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

December 31, 2003. In addition, we would be entitled to a 10% royalty on QQQ's net sublicensing revenues for a period of 36 months from the date of the contract. After the 36 months period, no royalty is due. In December 2003, we entered into a separate agreement to purchase from QQQ exclusive ownership and rights to use, market, reproduce and license QQQ's point of sale software (the "Technology") in Europe and North and South America for the purchase price of \$3.9 million. In addition, a portion of the future revenues from our sales of the Technology will be payable to QQQ as follows: (a) \$150,000 for unlimited number of copies from December 31, 2003 through June 30, 2004; (b) \$150,000 for unlimited number of copies from July 1, 2004 through April 30, 2005; (c) \$150,000 for unlimited number of copies from May 1, 2005 through April 30, 2006; (d) 20% of net revenue per copy thereafter; and (e) effective from the third anniversary of December 31, 2003, 20% of the net revenue earned by us during the previous year. We will continue sharing revenue until the total of all such shared revenue paid to QQQ has reached \$2,850,000. However, at any time after April 30, 2006, we may elect in our sole discretion to either to continue paying 20% revenue split until the total of all shared revenues is paid equal to \$2,850,000 or make a final, single payment to QQQ of \$200,000. Initially, the \$3.9 million purchase price was paid by offsetting the purchase price amount against the outstanding account receivable due to us from QQQ. Accordingly, in the quarter ended December 31, 2003, the receivable of \$3.9 million was eliminated and we recorded the \$3.9 million as an asset. However, subsequent to entering into these transactions, certain facts and circumstances relating to these transactions have changed. The management of QQQ has indicated that it does not desire to actively pursue opportunities for the IP products in Australia, while at the same time; our

6

new management has initiated discussions with a major Australian retailer about a sale of our products and now considers the Australian market a viable market for our products. As QQQ has an exclusive license for the Australian market, we are currently in negotiations with them to allow us to directly sell to this Australian retailer. As part of the restatement of the financial statements in this Form 10-Q/A, we have reversed the revenue and account receivable recognized at September 30, 2003 on this one time sale. Also, as part of the restatement, we have reserved the purchase of the technology recognized at December 31, 2003 as we cannot assign a value to the technology and eliminated the \$3.9 million asset from the balance sheet. In addition, in connection with the \$150,000 installments due to QQQ for royalties payable, we have accrued a liability and a deferred asset in the amount of \$450,000 at December 31, 2003, which is being amortized over the royalty period ending April 30, 2006. At December 31, 2003, \$240,000 of the royalty has been classified as a current liability out of the total amount payable of \$450,000 and \$240,000 of the deferred asset has been classified as a current asset.

NOTE 5 - CONVERTIBLE DEBT

Pursuant to the Discounted Loan Payoff Agreement dated March 31, 2003, we issued to Union Bank of California a \$500,000 unsecured, non-interest bearing convertible note payable in either cash or shares of common stock, at our option. The maturity date would have been March 31, 2004. In July 2003, the bank assigned the note to Roth Capital Partners, LLC ("Roth Capital"), who was the placement agent for the financings in June and November 2003. In January 2004, we elected to repay the note in shares of common stock and issued 239,739 shares at a price of \$2.08 per share which was 80% of the average share closing price of our common stock for the ten trading day period immediately preceding the

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

payoff date.

NOTE 6 - CONVERTIBLE NOTE

In November 2003, we entered an agreement with Toys "R" Us, Inc. ("Toys") to terminate the software development and services agreement. Pursuant to the agreement, the \$1.3 million outstanding convertible note, which would have been converted solely for equity. Pursuant to the termination agreement, this note was settled in full by offsetting against account receivable due to us from Toys, as opposed to issuance of common stock, and the warrant to purchase 2,500,000 shares of our common stock was cancelled.

NOTE 7 - CHANGE IN ACCOUNTING PRINCIPLE

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," which is effective for fiscal years beginning after December 15, 2001. SFAS 142 prohibits the amortization of goodwill and intangible assets with indefinite useful lives but requires that these assets be reviewed for impairment at least annually or on an interim basis if an event occurs or circumstances change that could indicate that their value has diminished or been impaired. Other intangible assets will continue to be amortized over their estimated useful lives. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of goodwill.

Effective April 1, 2002, we adopted SFAS 142 and ceased amortization of goodwill recorded in business combinations prior to June 30, 2001. We evaluate the remaining useful lives of these intangibles on an annual basis to determine whether events or circumstances warrant a revision to the remaining period of amortization.

Pursuant to SFAS 142, we completed the transitional analysis of goodwill impairment as of April 1, 2002 and recorded an impairment of \$627,000 as a cumulative effect of a change in accounting principle in the quarter ended June 30, 2002.

NOTE 8 - PREFERRED STOCK

The Series A Convertible Preferred Stock (the "Series A Preferred") has a stated value of \$100 per share and is redeemed at our option any time prior to the maturity date of December 31, 2006 for 107% of the stated value and accrued and unpaid dividends. The preferred shares are entitled to cumulative dividends of 7.2% per annum, payable semi-annually, and have cumulative dividends of \$1.7 million, or \$12.17 per share, and \$1.0 million, or \$7.33 per share, at December 31, 2003 and 2002, respectively. The holders may convert each share of Series A Preferred at any time into the number of shares of our common stock determined by dividing the stated value plus all accrued and unpaid dividends, by a conversion price initially equal to \$0.80. The conversion price increases at an annual rate of 3.5% calculated on a semi-annual basis. The conversion price as of January 1, 2004 is \$0.86. The Series A Preferred is entitled upon liquidation

to an amount equal to its stated value plus accrued and unpaid dividends in preference to any distributions to common stockholders. The Series A Preferred

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

has no voting rights prior to conversion into common stock, except with respect to proposed impairments of the Series A Preferred rights and preferences, or as provided by law. We have the right of first refusal to purchase all but not less than all of any shares of Series A Preferred or shares of common stock received on conversion which the holder may propose to sell to a third party, upon the same price and terms as the proposed sale to a third party.

An option agreement (the "Option Agreement") was prepared and agreed upon by Softline Limited ("Softline") and Steven Beck, our president, chief operating officer and director, as trustee of a certain group of our management (the "Optionees"). Under the Option Agreement, Softline agreed to grant the Optionees the right to purchase from Softline 8,000,000 shares of our common stock and such number of shares of Series A Preferred convertible into 17,125,000 shares of our common stock for a price of \$0.80 per option share. The Option Agreement expires on the earlier of March 24, 2004 and the date on which an Optionee's full-time employment as our officer or director is terminated for any reason.

On November 14, 2003, the Sage Group plc (the "Sage Group") acquired substantially all the assets of Softline, including Softline's 141,000 shares of our Series A Preferred, 8,923,915 shares of our common stock and options to purchase 71,812 shares of our common stock. In connection with the acquisition, certain agreements of Softline, including the rights and obligations respecting and arising from the Option Agreement were also assigned to and assumed by the Sage Group. Accordingly, the Optionees now have the right to purchase the option shares from the Sage Group for a price of \$0.80 per option share. The right to exercise the option is to be distributed as determined by our Board to the Optionees, who may include Mr. Beck and other members of our management, as an incentive to continue service for us. It is the current intent of the Optionees to transfer their rights under the Option Agreement to us. On September 17, 2003, 500,000 shares of common stock constituting accrued dividends on our Series A Preferred were issued in the names of various financial institutions.

NOTE 9 - PRIVATE PLACEMENTS

In June 2003, we sold various institutional investors ("June 2003 Institutional Investors") 5,275,000 shares of common stock at a per share price of \$1.50 for an aggregate purchase price of \$7.9 million. In connection with this financing, we paid Roth Capital, as placement agent, cash compensation of 8% of the proceeds and issued a five-year warrant to purchase 527,500 shares of common stock at an exercise price of \$1.65 per share, with a fair market value of \$859,000. We also issued five-year warrants to purchase 375,000 shares of common stock at an exercise price of \$1.65, with a fair market value of \$620,000, to the holders of our 9% convertible debentures in order to obtain their requisite consents and waivers of rights they possessed to participate in the financing. In accordance with the warrant agreements, these warrants were adjusted to \$1.55 due to the sale of common stock at the price of \$1.55 on November 7, 2003. We filed a registration statement covering the shares sold and common stock underlying the warrants issued in connection with this transaction. The registration statement was declared effective on September 26, 2003.

On November 7, 2003, we sold various institutional investors ("November 2003 Institutional Investors") 3,180,645 shares of common stock at a price of \$1.55 per share for an aggregate purchase price of \$4.9 million. In connection with this financing, we paid Roth Capital, as placement agent, compensation of \$179,000 in cash and 115,226 shares of our common stock and issued a five-year warrant to purchase 282,065 shares of our common stock at an exercise price of \$1.71 per share, with a fair market value of \$388,000. Roth Capital was granted the registration rights similar to those granted to the November 2003 Institutional Investors. Pursuant to a registration rights agreement, we filed a registration statement covering the shares sold and common stock underlying the warrants issued in connection with this transaction. The registration statement was declared effective on February 3, 2004.

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

NOTE 10 - EARNINGS (LOSS) PER SHARE (AS RESTATED)

Basic earnings (loss) per common share are calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the reporting period. Diluted earnings per common shares ("diluted EPS") reflect the potential dilutive effect, determined by the treasury method, of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Earnings per share for the three and nine months ended December 31, 2003 and 2002 is calculated as follows (in thousands):

	Three months ended December 31,		Nine months ended December 31,	
	2003	2002	2003	2002
	-----	-----	-----	-----
	(As restated)		(As restated)	
Net income (loss) available to common stockholders	\$ (658)	\$ 131	\$ (5,403)	\$ (5,361)
	=====	=====	=====	=====
Basic weighted average shares	46,172	30,395	38,656	29,257
Dilutive common stock equivalent	--	28,339	--	--
	-----	-----	-----	-----
Diluted weighted average shares	46,172	58,734	38,656	29,257
	=====	=====	=====	=====
Basic earnings (loss) per share	\$ (0.01)	\$ --	\$ (0.14)	\$ (0.18)
Diluted earnings (loss) per share	\$ (0.01)	\$ --	\$ (0.14)	\$ (0.18)

The following potential common shares have been excluded from the computation of diluted net loss per share for the three and nine months ended December 31, 2003 and nine months ended December 31, 2002, because the effect would have been anti-dilutive:

	Three and Nine months ended December 31, 2003

Outstanding options under our stock option plans	4,371,974
Outstanding options granted outside our stock option plans	4,994,312
Warrants issued in conjunction with private placements	3,830,281
Warrants issued for services rendered	1,108,898
Warrant issued to a major customer	--
Convertible notes due to stockholders	--

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

Convertible note due to a major customer	--
Convertible note	239,739
Series A Convertible Preferred Stock	18,449,674

Total	32,994,878
	=====

NOTE 11 - BUSINESS SEGMENTS AND GEOGRAPHIC DATA (AS RESTATED)

We are a provider of software solutions and services to the retail industry. We provide high value innovative solutions that help retailers understand, create, manage and fulfill consumer demand. Our solutions and services have been developed specifically to meet the needs of the retail industry. Our solutions help retailers improve the efficiency and effectiveness of their operations and build stronger, longer lasting relationships with their customers. We currently operate in the United States and the United Kingdom. The geographic distribution of our revenues and long-lived assets are as follows (in thousands):

9

	Three months ended		Nine months ended	
	December 31,		December 31,	
	2003	2002	2003	2002
	-----		-----	
	(As restated)		(As restated)	
Revenues:				
United States	\$ 3,275	\$ 6,238	\$10,489	\$13,891
United Kingdom	1,615	880	2,646	1,917
	-----		-----	
Total revenues	\$ 4,890	\$ 7,118	\$13,135	\$15,808
	=====		=====	

	December 31,	March 31,
	2003	2003

	(As restated)	
Identifiable assets from continuing operations:		
United States	\$ 41,668	\$ 37,146
United Kingdom	2,651	491

Total identifiable assets	\$ 44,319	\$ 37,637
	=====	

For the three and nine months ended December 31, 2003 and 2002, revenues from major customers are as follows (in thousands):

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

	Three months ended December 31,		Nine months ended December 31,	
	2003	2002	2003	2002
	-----	-----	-----	-----
The Perfume Shop	16%	--%	6%	--
Toys	--%	25%	12%	3

The account receivable balances from the Perfume Shop at December 31, 2003 represent 13% of total accounts receivable. The account receivable balances from Toys at December 31, 2003 and 2002 represent 13% and 15%, respectively, of total accounts receivable.

We organize our business into two segments as follows:

- o RETAIL MANAGEMENT SOLUTIONS - offers suite of applications, which builds on our long history in retail software design and development. We provide our customers with an extremely reliable, widely deployed, comprehensive and fully integrated retail management solution. Retail Management Solutions include merchandise management that optimizes workflow and provides the highest level of data integrity. This module supports all operational areas of the supply chain including planning, open-to-buy purchase order management, forecasting, warehouse and store receiving distribution, transfers, price management, performance analysis and physical inventory. In addition, Retail Management Solutions include a comprehensive set of tools for analysis and planning, replenishment and forecasting, event and promotion management, warehouse, ticketing, financials and sales audit. Through collaborations with strategic partners, Retail Management Solutions offers tools for loss prevention, communication with stores and vendors, integration needs, purchase and allocation decisions, analysis of weather impact, control and management of business processes, consumer research, tracking consumer shopping patterns, forecasting and replenishment, and analyzing store people productivity.

10

- o STORE SOLUTIONS - offers suite of applications builds on our long history of providing multi-platform, client server in-store solutions. We market this set of applications under the name "OnePointe," and "OnePointe International" which is a full business to consumer software infrastructure encompassing a range of integrated store solutions. "OnePointe" is a complete application providing all point-of-sale ("POS") and in-store processor (server) functions for traditional "brick and mortar" retail operations.

A summary of the revenues and operating income (loss) attributable to each of

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

these business units and identifiable assets is as follows (in thousands):

	Three months ended December 31,		Nine D 2003
	2003	2002	2003
	(As restated)		(As restate
Revenues:			
Retail Management Solutions	\$ 4,602	\$ 6,383	\$ 12,07
Store Solutions	288	735	1,06
Total revenues	\$ 4,890	\$ 7,118	\$ 13,13
Operating income (loss):			
Retail Management Solutions	\$ 300	\$ 988	\$ (7
Store Solutions	(299)	235	(93
Other (see below)	(613)	(639)	(2,32
Total operating income (loss)	\$ (612)	\$ 584	\$ (3,34
Other operating loss:			
Depreciation	\$ (4)	\$ (22)	\$ (2
Administrative costs and other non-allocated expenses	(609)	(617)	(2,30
Total other operating loss	\$ (613)	\$ (639)	\$ (2,32
December 31, March 31,			
2003 2003			
(Restated)			
Identifiable assets:			
Retail Management Solutions	\$ 35,963	\$ 31,953	
Store Solutions	4,036	4,404	
Total identifiable assets	\$ 39,999	\$ 36,357	
Goodwill:			
Retail Management Solutions	\$ 13,903	\$ 13,903	
Store Solutions	892	892	
Total goodwill	\$ 14,795	\$ 14,795	

Operating income (loss) in Retail Management Solutions and Store Solutions includes direct expenses for software licenses, maintenance services, programming and consulting services, sales and marketing expenses, product development expenses, and direct general and administrative expenses. The "Other" caption includes non-allocated costs and other expenses that are not directly identified with a particular business unit and which management does not consider in evaluating the operating income of the business unit.

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

NOTE 12 - RECENT ACCOUNTING PRONOUNCEMENTS (AS RESTATED)

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 ("SFAS 148"), "Accounting for Stock-Based Compensation-Transition and Disclosure." This Statement amends SFAS 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. We are currently evaluating which method of transition to fair value accounting we will elect.

The following table presents pro forma disclosures required by SFAS 148 of net income (loss) and basic and diluted earnings (loss) per share as if stock-based employee compensation had been recognized during the nine months ended December 31, 2003 and 2002. The compensation expense for these periods has been determined under the fair value method using the Black-Scholes pricing model, and assumes graded vesting.

	NINE MONTHS ENDED	
	DECEMBER 31, 2003	DECEMBER 31, 2002

	(As restated)	
	(in thousands, except per share amounts)	
	(unaudited)	

Net loss as reported	\$ (4,665)	\$ (4,600)
Less: stock-based compensation expense, net of related tax effects	(1,621)	(1,285)
	-----	-----
Pro forma net loss	\$ (6,286)	\$ (5,885)
	=====	=====
Basic and diluted earnings (loss) per share - as reported	\$ (0.12)	\$ (0.16)
Basic and diluted earnings (loss) per share - pro forma	\$ (0.16)	\$ (0.20)

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149 ("SFAS 149"), "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 149 further clarifies accounting for derivative instruments. We believe the adoption of this statement will have no material impact on our consolidated financial statements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No.

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," ("SFAS 150"). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Upon adoption of SFAS 150, the convertible note payable to Toys was re-classified from equity to liabilities at September 30, 2003.

12

NOTE 13 - ACQUISITIONS

On January 30, 2004, we acquired Page Digital Incorporated ("Page Digital"), a developer of multi-channel commerce software, through a merger transaction for total consideration of \$7.1 million, consisting of \$2.0 million in cash, 2.5 million shares of our common stock valued at \$2.00 and acquisition costs of \$138,000. Upon the consummation of this transaction Lawrence Page and Dave Joseph became executive officers of Island Pacific. Mr. Page received total consideration of \$1.4 million and 1,755,784 shares of our common stock in connection with the acquisition. Mr. Joseph received total consideration of \$200,000 and 249,649 shares of our common stock in connection with the acquisition. The balance of \$395,755 and 494,526 shares of common stock were paid to the remaining shareholders of Page Digital. We also entered two year employment agreements with both Mr. Page and Mr. Joseph, and a two year non-competition agreement with Mr. Page. Page Digital has total assets of approximately \$2.0 million (unaudited) and generates annual revenues of approximately \$6.0 million (unaudited). Page Digital has approximately 37 employees, all of whom were based in the United States.

On January 6, 2004, we executed a letter of intent to acquire Retail Technologies International, Inc. ("RTI"), a provider of management systems for retailers, for a purchase price of \$11 million, consisting of \$5 million in cash, and \$6 million in shares of our common stock determined by dividing \$6 million by the average closing price of our common stock over the ten day period immediately preceding the closing of the transaction. In addition, we will assume approximately \$2.5 million in debt owed to certain RTI security holders. The closing of the transaction is subject to securing financing, due diligence, the execution of a definitive agreement, the approval of our board of directors and the approvals of the board of directors and the shareholders of RTI. There can be no assurance that we will be able to secure the necessary financing to complete the acquisition of RTI. RTI has total assets of approximately \$4.3 million (unaudited) and generates annual revenues of approximately \$8.0 million (unaudited). RTI has approximately 59 employees, all of whom are based in the United States.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

In June 2003, we entered into a development and marketing license agreement with a software and services company affiliated with our former officer. Under this agreement, we obtain an exclusive right to sell and distribute this company's software. In return, we committed to fund \$1.2 million toward development of

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

this product. We also agreed to pay a royalty of 30% of the software license sales up until we have recuperated all the development funding, at which point the royalty will increase to 50% thereafter. As of December 31, 2003, we've funded \$545,000 toward development which is included in prepaid expenses.

In April of 2002, our former CEO, Thomas Dorosewicz, filed a demand with the California Labor Commissioner for \$256,250 in severance benefits allegedly due under a disputed employment agreement, plus attorney's fees and costs. Mr. Dorosewicz's demand was later increased to \$283,894. On June 18, 2002, we filed an action against Mr. Dorosewicz, Michelle Dorosewicz and an entity affiliated with Mr. Dorosewicz in San Diego Superior Court, Case No. GIC790833, alleging fraud and other causes of action relating to transactions Mr. Dorosewicz caused us to enter into with his affiliates and related parties without proper board approval. On July 31, 2002, Mr. Dorosewicz filed cross-complaints in that action alleging breach of statutory duty, breach of contract, fraud and other causes of action related to his employment with us and other transactions he entered into with us. This dispute was heard by an arbitrator the week of October 3, 2003. The arbitrator issued an award on November 7, 2003, resolving most of the disputed issues in favor of the Company as follows: (a) the Company was awarded a refund of rental payments amounting to \$66,950.76; (b) the excessive equipment leasing financing charges by Mr. Dorosewicz were recast substantially reducing the Company's unpaid balance; (c) Mr. Dorosewicz was ordered to repay attorneys' fees reimbursement he had previously been provided by the Company; (d) Mr. Dorosewicz was denied severance benefits; (e) Mr. Dorosewicz's claims with respect to options were denied; and (f) Mr. Dorosewicz was awarded his unpaid bonus in the amount of \$56,719. The net amount awarded to Mr. Dorosewicz was \$85,339.09 which was paid in January 2004.

13

We decided in the third quarter of fiscal 2002 to sell certain assets of our Australian subsidiary to the former management of such subsidiary, and then cease Australian operations. Such sale was, however, subject to the approval of National Australia Bank, the subsidiary's secured lender. The bank did not approve the sale and the subsidiary ceased operations in February 2002. The bank caused a receiver to be appointed in February 2002 to sell substantially all of the assets of the Australian subsidiary and pursue collections on any outstanding receivables. The receiver proceeded to sell substantially all of the assets for \$300,000 in May 2002 to an entity affiliated with the former management, and is actively pursuing the collection of receivables. If the sale proceeds plus collections on receivables are insufficient to discharge the indebtedness to National Australia Bank, we may be called upon to pay the deficiency under our guarantee to the bank. We have reserved \$187,000 as our potential exposure. The receiver has also claimed that we are obligated to it for inter-company balances of \$636,000, but we do not believe any amounts are owed to the receiver, who has not as of the date of this report acknowledged the monthly corporate overhead recovery fees and other amounts charged by us to the Australian subsidiary offsetting the amount claimed to be due.

On May 15, 2002, an employee who is currently out on disability/worker's compensation leave, Debora Hintz, filed a claim with the California Labor Commissioner seeking \$41,000 in alleged unpaid commissions. On or about December of 2002, Ms. Hintz filed a discrimination claim against us with the Department of Fair Employment and Housing, alleging harassment and sexual orientation discrimination. We have responded appropriately to both the wage claim and the discrimination allegations, which we believe lack merit based on present information. On December 1, 2003, the Department of Fair Housing and Employment closed the case on the basis of no probable cause to prove violation of statute,

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

and gave notice of right to sue.

On August 30, 2002, Cord Camera Centers, Inc., an Ohio corporation ("Cord Camera"), filed a lawsuit against one of our subsidiaries, SVI Retail, Inc. ("SVI Retail") as the successor to Island Pacific Systems Corporation, in the United States District Court for the Southern District of Ohio, Eastern Division, Case No. C2 02 859. The lawsuit claimed damages in excess of \$1.5 million, plus punitive damages of \$250,000, against SVI Retail for alleged fraud, negligent misrepresentation, breach of express warranties and breach of contract. These claims pertained to the following agreements between Cord Camera and Island Pacific: (i) a License Agreement, dated December 1999, as amended, for the use of certain software products, (ii) a Services Agreement for consulting, training and product support for the software products and (iii) a POS Software Support Agreement for the maintenance and support services for a certain software product. The parties settled this matter in September 2003. The terms of the settlement agreement are covered by a confidentiality covenant.

In mid-2002, we were the subject of an adverse judgment entered against us in favor of Randall's Family Golf Centers, ("Randall") in the approximate sum of \$61,000. The judgment was entered as a default judgment, and is based on allegations that we received a preferential transfer of funds within 90 days of the filing by Randall of a chapter 11 case in the United States Bankruptcy Court for the Southern District of New York. We settled this matter by an agreement to pay \$12,500 to Randall.

On November 22, 2002, UDC Homes, Inc and UDC Corporation now known as Shea Homes, Inc. served Sabica Ventures, Inc. ("Sabica"), our wholly-owned subsidiary, and Island Pacific, then an operating division of SVI Solutions, Inc. (now our retail management solutions division) with a cross-complaint for indemnity on behalf of an entity identified in the summons as Pacific Cabinets. Sabica and Island Pacific filed a notice of motion and motion to quash service of summons on the grounds that neither Sabica nor Island Pacific has ever done business as Pacific Cabinets and has no other known relation to the construction project that is the subject of the cross-complaint and underlying complaint. Our motion to quash was denied in a hearing on May 22, 2003.

Certain of our standard software license agreements contain a limited infringement indemnity clause under which we agree to indemnify and hold harmless our customers and business partners against certain liability and damages arising from claims of various copyright or other intellectual property infringement by our products. These terms constitute a form of guarantee that is subject to the disclosure requirements, but not the initial recognition or measurement provisions of Financial Accounting Standards Board issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of the Indebtedness of others." We have never lost an infringement claim and our cost to defend such lawsuits have been insignificant. Although it is possible that in the future third parties may claim that our current or potential future software solutions infringe on their intellectual property, we do not currently expect a significant impact on our business, operating results or financial condition.

Except as set forth above, we are not involved in any material legal proceedings, other than ordinary routine litigation proceedings incidental to our business, none of which are expected to have a material adverse effect on our financial position or results of operations. However, litigation is subject to inherent uncertainties, and an adverse result in existing or other matters may arise from time to time which may harm our business.

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

NOTE 15 - RELATED-PARTY TRANSACTIONS

We retain our former CEO and Chairman of the Board to provide consulting services starting August 2003. For the three and nine months ended December 31, 2003, the expense for this service was \$113,000 and \$187,000, respectively.

We retained an entity owned by an immediate family member of our current CEO and Chairman to provide recruiting and marketing services. For the three and nine months ended December 31, 2003, the expense for this service was \$10,000 and \$118,000.

In June 2003, we entered into a development and marketing license agreement with a software and services company affiliated with a former officer. Under this agreement, we obtain an exclusive right to sell and distribute this company's software. In return, we committed to fund \$1.2 million toward development of this product. We also agreed to pay a royalty of 30% of the software license sales up until we have recuperated all the development funding, at which point the royalty will increase to 50% thereafter. As of December 31, 2003, we've funded \$545,000 toward this development.

NOTE 16 - RESTATEMENT

Subsequent to the issuance of our condensed consolidated financial statements for the three and nine-month periods ended December 31, 2003, our management determined that:

- o The recognition of revenue from a one-time sale of software technology rights should be reversed,
- o The revenues and cost of revenues should be presented separately as product and services revenues and corresponding cost of revenues,
- o The amortization expense of purchased and capitalized software should be reported as cost of product revenue,
- o The purchase of software technology ("Software Technology") should be reversed,
- o The royalty liability and deferred asset pursuant to the purchase agreement of Software Technology should be accrued,
- o The beneficial conversion charges related to convertible debt should be capitalized and amortized over the term of the debt,
- o The legal fees related to the acquisition of Page Digital Incorporated should be capitalized as acquisition costs, and
- o The restatements made in prior periods should be reflected.

As a result, the condensed consolidated financial statements for the three and

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

nine-month periods ended December 31, 2003 have been restated from the amounts previously reported. A summary of the significant effects of the restatement is as follows:

	As Previously Reported	Restatement Adjustment
	-----	-----
At December 31, 2003:		
Prepaid expenses and other current assets	\$ 965	\$ 2
Current assets	12,303	2
Purchased and capitalized software, net	19,854	(3,9
Other assets	29	3
Total assets	47,659	(3,3
Accrued expenses	2,454	2
Other long-term liabilities	65	2
Total liabilities	6,992	4
Additional paid-in capital	66,652	1,2
Accumulated deficit	(40,090)	(5,0
Total stockholders' equity	40,667	(3,7
For the three-month period ended December 31, 2003:		
Cost of revenues	\$ 1,411	\$ 6
Gross profit	3,479	(6
Depreciation and amortization	922	(6
Selling, general and administrative expenses	2,918	(1
Total expenses	4,201	(7
Net loss	(584)	1
Net loss available to common stockholders	(768)	1
Basic and diluted EPS available to common stockholders	(0.02)	(0.
For the nine-month period ended December 31, 2003:		
Revenues	\$ 17,035	\$ (3,9
Cost of revenues	4,139	1,8
Gross profit	12,896	(5,7
Application development expense	1,044	
Depreciation and amortization expense	2,688	(1,8
Selling, general and administrative expense	8,715	(1
Interest expense	(521)	(1,2
Net income (loss)	400	(5,0
Net loss available to common stockholders	(338)	(5,0
Basic and diluted EPS available to common stockholders	(0.01)	(0.

1. Prepaid expenses and other current assets were revised to include current portion of prepaid royalty fees in the amount of \$240,000.
2. Purchased and capitalized software was revised to reverse a software purchased in the amount of \$3.9 million.
3. Other assets was revised to include long-term portion of prepaid royalty fees in the amount of \$210,000 and \$110,000 acquisition costs previously expensed as selling, general and administrative expense.

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

4. Accrued expenses and other long-term liabilities were revised to include royalty fee accrual of \$240,000 current portion and \$210,000 long-term portion, respectively.
5. Additional paid-in capital was revised to reflect the proper amortization of debt discount previously charged against additional paid-in capital.
6. Accumulated deficit was revised to reverse \$3.9 million in revenue from a one-time sale of software technology rights, capitalize acquisition costs of \$110,000 and recognize amortization expense of \$1,275,000 in connection with the debt discount and beneficial conversion interest charges on the March '03, April '03 and May '03 debt financings.
7. Total revenues were revised to reverse recognition of \$3.9 million revenue from a one-time sale of software technology rights in the nine-month period ended December 31, 2003.
8. Cost of revenues was revised to include \$650,000 and \$1,851,000 amortization of purchased and capitalized software in the three and nine-month periods ended December 31, 2003, respectively, previously reported as depreciation and amortization expense, and to re-classify \$39,000 expense to application development expense in the nine-month period ended December 31, 2003.
9. Application development expense was revised to include \$39,000 expense in the nine-month period ended December 31, 2003.
10. Depreciation and amortization was revised to re-classify \$650,000 and \$1,851,000 amortization of purchased and capitalized software in the three and nine-month periods ended December 31, 2003, respectively, to cost of revenues.
11. Selling, general and administrative expenses were revised to re-classify \$110,000 acquisition costs for Page Digital acquisitions as goodwill.
12. Interest expense was revised to recognize amortization expense in connection with debt discount and beneficial conversion interest charges of \$1,275,000 on the March '03, April '03 and May '03 debt financings.

17

ITEM 2. - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933 AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934 AND THE COMPANY INTENDS THAT CERTAIN MATTER DISCUSSED IN THIS REPORT ARE "FORWARD-LOOKING STATEMENTS" INTENDED TO QUALIFY FOR THE SAFE HARBOR FROM LIABILITY ESTABLISHED BY THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. THESE FORWARD-LOOKING STATEMENTS CAN GENERALLY BE IDENTIFIED BY THE CONTEXT OF THE STATEMENT WHICH MAY INCLUDE WORDS SUCH AS THE COMPANY ("IPI", "WE" OR "US") "BELIEVES", "ANTICIPATES", "EXPECTS", "FORECASTS", "ESTIMATES" OR OTHER WORDS SIMILAR MEANING AND CONTEXT. SIMILARLY, STATEMENTS THAT DESCRIBE FUTURE PLANS, OBJECTIVES, OUTLOOKS, TARGETS, MODELS, OR GOALS ARE ALSO DEEMED FORWARD-LOOKING STATEMENTS. THESE FORWARD-LOOKING STATEMENTS ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE FORECASTED OR ANTICIPATED AS OF THE DATE OF THIS REPORT. CERTAIN OF SUCH RISKS

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

AND UNCERTAINTIES ARE DESCRIBED IN CLOSE PROXIMITY TO SUCH STATEMENTS AND ELSEWHERE IN THIS REPORT INCLUDING ITEM 2, "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS." STOCKHOLDERS, POTENTIAL INVESTORS AND OTHER READERS ARE URGED TO CONSIDER THESE FACTORS IN EVALUATING THE FORWARD-LOOKING STATEMENTS AND ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON SUCH FORWARD-LOOKING STATEMENTS OR CONSTRUE SUCH STATEMENTS TO BE A REPRESENTATION BY US THAT OUR OBJECTIVES OR PLANS WILL BE ACHIEVED. THE FORWARD-LOOKING STATEMENTS INCLUDED IN THIS REPORT ARE MADE ONLY AS OF THE DATE OF THIS REPORT, AND WE UNDERTAKE NO OBLIGATION TO PUBLICLY UPDATE SUCH FORWARD-LOOKING STATEMENTS TO REFLECT SUBSEQUENT EVENTS OR CIRCUMSTANCES.

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES AND OTHER FINANCIAL INFORMATION APPEARING ELSEWHERE IN THIS FORM 10-Q/A. READERS ARE ALSO URGED TO CAREFULLY REVIEW AND CONSIDER THE VARIOUS DISCLOSURES MADE BY US WHICH ATTEMPT TO ADVISE INTERESTED PARTIES OF THE FACTORS WHICH AFFECT OUR BUSINESS, INCLUDING WITHOUT LIMITATION THE DISCLOSURES MADE UNDER THE CAPTION "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS," AND THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES INCLUDED IN OUR ANNUAL REPORT FILED ON FORM 10-K/A FOR THE YEAR ENDED MARCH 31, 2003, AND THE DISCLOSURES UNDER THE HEADING "RISK FACTORS" IN THE FORM 10-K/A, AS WELL AS OTHER REPORTS AND FILINGS MADE WITH THE SECURITIES AND EXCHANGE COMMISSION.

OVERVIEW

We are a provider of software solutions and services to the retail industry. We provide solutions that help retailers understand, create, manage and fulfill consumer demand. We derive the majority of our revenues from three sources: the initial sale of application software licenses, or license revenues, professional services and support, or maintenance services. Application software license fees are dependent upon the sales volume of our customers, the number of users of the application(s), and/or the number of locations in which the customer plans to install and utilize the application(s). As the customer grows in sales volume, adds additional users and/or adds additional locations, we charge additional license fees. Professional services relate to implementation of our software, training of customer personnel and modification or customization work. Support, maintenance and software updates are a source of recurring revenues and are generally based on a percentage of the software license revenues and are charged on an annual basis pursuant to renewable maintenance contracts. We typically charge for professional services including consulting, implementation and project management services on an hourly basis.

As the vast majority of our revenues are derived from the retail industry, we are heavily dependent on the financial strength of retailers and their capital budgets. Deterioration in the health of retailers or a reduction in their capital budget or a decision to delay the purchase of new systems have a direct impact on our business. Our sales cycles are long, generally three to twelve months, and our ability to close a pipeline of potential transaction is very unpredictable. As such, management believes that license revenue and growth in license revenue are the best indicator of the Company's business as they signify either new customers or an expansion of licenses of existing customers. While there's generally a time lag between a sale of new license and when we provide services and support, an increase in license revenue will generally lead to an increase in services and support revenues in future quarters.

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

RESTATEMENT OF QUARTERLY INFORMATION

As discussed in the notes to condensed consolidated financial statements, we restated our December 31, 2003 financial statements to:

1. Reverse recognition of revenue from a one-time sale of software technology rights,
2. Present revenues and cost of revenues separately as product and services revenues and corresponding cost of revenues,
3. Report amortization expense of software products as cost of product revenue,
4. Reverse a purchase of software technology ("Software Technology"),
5. Accrue royalty liability and deferred asset pursuant to the purchase agreement of Software Technology,
6. Capitalize and amortize beneficial conversion interest charges and debt discount on convertible debt over the term of the debt. 7. Capitalize acquisition costs totaling \$110,000 related to the acquisition of Page Digital Incorporated, and
8. Reflect restatements made in prior periods.

These changes had no impact on the net cash flows from operations.

RECENT DEVELOPMENTS

In October 2003, Donald Radcliffe resigned as a member of our Board Directors. Mr. Radcliffe was hired in December 2003 as a part-time employee handling investor relations.

In November 2003, we entered into an agreement with various institutional investors for the sale of 3,180,645 shares of common stock at a price of \$1.55 per share for an aggregate purchase price of \$4.9 million. See "Liquidity and Capital Resources -- Financing Transactions" below.

In November 2003, we entered into an agreement with Toys "R" Us, Inc. ("Toys") to terminate the software development and services agreement. Pursuant to the agreement, the outstanding convertible note was settled in full and the outstanding warrant was cancelled. For further details, see "Indebtedness - Toys "R" Us, Inc." below.

In December 2003, we purchased from QQQ Systems Pty Limited an exclusive right to use, market and license a point-of-sale software in Europe and North and South America for a purchase price of \$3.9 million.

In January 2004, we issued 239,739 shares of common stock to repay a \$500,000 convertible note. This note was originally issued to Union Bank of California in March 2003 and subsequently assigned by Union Bank of California to Roth Capital Partners, LLC.

Upon the consummation of the acquisition of Page Digital Incorporated ("Page Digital") on January 30, 2004, Lawrence Page and Dave Joseph were appointed to the positions of Chief Technology Officer and Senior Vice President-Sales and Marketing, respectively.

ACQUISITION OF PAGE DIGITAL

On January 30, 2004, we acquired Page Digital, a developer of multi-channel commerce software, through a merger transaction for total consideration of \$7.1

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

million, consisting of \$2.0 million in cash, 2,500,000 shares of our common shares valued at \$2.00 and acquisition costs totaling \$138,000. Upon the consummation of this transaction, Lawrence Page and Dave Joseph became executive officers of Island Pacific. Mr. Page received total consideration of \$1,404,630 and 1,755,784 shares of our common stock in connection with the acquisition. Mr. Joseph received total consideration of \$199,722 and 249,649 shares of our common stock in connection with the acquisition. The balance of \$395,755 and 494,526 shares of common stock were paid to the remaining shareholders of Page Digital. We also entered two year employment agreements with both Mr. Page and Mr. Joseph, and a two year non-competition agreement with Mr. Page. Page Digital has total assets of approximately \$2.0 million (unaudited) and generates annual revenues of approximately \$6.0 million (unaudited). Page Digital has approximately 37 employees, all of whom are based in the United States.

19

The legitimization of business to business and business to consumer direct commerce (Internet, brick-and-mortar, catalog, and other) has rapidly created a substantial market for the Page Digital suite of direct commerce applications. According to the United States Department of Commerce, the market for multi-channel direct commerce applications was just \$15 billion in 1999, grew to \$27.28 billion in 2000, and to \$32.6 billion in 2001, and it is growing at a rate 2.5 times greater than traditional retailing (Source: Internet Retailer, April 2002). The acquisition of Page Digital will enable us to continue to provide our customers with Page Digital's e-commerce, customer relations management, and Catalog Management solutions. We expect to further integrate these solutions into our offerings to enable customers to complete the multi-channel retail distribution and customer service chain. In addition, the acquisition will also allow us to offer Page Digital's customers the IP Merchandising solution, as well as Point of Sale, Loss Prevention, and IPI's other alliance solutions.

ACQUISITION OF RTI

On January 6, 2004, we executed a Letter of Intent/Term Sheet pursuant to which we intend to acquire RTI, a provider of management systems for retailers, for a purchase price of \$11 million, consisting of \$5 million in cash, and \$6 million in shares of our common stock determined by dividing \$6 million by the average closing price of the Company's common stock over the ten day period immediately preceding the closing of the transaction. In addition, we will assume approximately \$2.5 million in debt owed to certain RTI security holders. The closing of the transaction is subject to securing financing, due diligence, the execution of a definitive agreement, the approval of the board of directors of the Company and the approvals of the board of directors and the shareholders of RTI. There can be no assurance that the Company will be able to secure the necessary financing to complete the acquisition of RTI. RTI has total assets of approximately \$4.3 million (un-audited) and generates annual revenues of approximately \$8.0 million (un-audited.) RTI has approximately 59 employees, all in the United States.

The combination of Island Pacific, RTI and Page Digital, will enable us to offer a fully integrated solution to mid-tier retailers that will be unique in the marketplace. As a result of this transaction, smaller retailers will now be able to cost-effectively acquire a solution that provides both front and back-end support. We anticipate that RTI will assume responsibility to market IP Express through its distribution channel, including 64 resellers, which will expand our ability to effectively market IP Express, while Island Pacific will continue to

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

market our enterprise applications to our traditional market, mid-tier retailers. The combination instantly expands our products, services offerings and distribution channels.

OPTION AGREEMENT

An option agreement (the "Option Agreement") was prepared and agreed upon by Softline Limited ("Softline") and Steven Beck, our president, chief operating officer and director, as trustee of a certain group of our management (the "Optionees"). Under the Option Agreement, Softline agreed to grant the Optionees the right to purchase from Softline 8,000,000 shares of our common stock and such number of shares of Series A Preferred convertible into 17,125,000 shares of our common stock for a price of \$0.80 per option share. The Option Agreement expires on the earlier of March 24, 2004 and the date on which an Optionee's full-time employment as our officer or director is terminated for any reason.

On November 14, 2003, the Sage Group plc (the "Sage Group") acquired substantially all the assets of Softline, including Softline's 141,000 shares of our Series A Preferred, 8,923,915 shares of our common stock and options to purchase 71,812 shares of our common stock. In connection with the acquisition, certain agreements of Softline, including the rights and obligations respecting and arising from the Option Agreement were also assigned to and assumed by the Sage Group. Accordingly, the Optionees now have the right to purchase the option shares from the Sage Group for a price of \$0.80 per option share. The right to exercise the option is to be distributed as determined by our Board to the Optionees, who may include Mr. Beck and other members of our management, as an incentive to continue service for us. It is the current intent of the Optionees to transfer their rights under the Option Agreement to us. On September 17, 2003, 500,000 shares of common stock constituting accrued dividends on our Series A Preferred Stock were issued in the names of various financial institutions.

20

DISCONTINUED OPERATIONS

Effective April 1, 2003, we sold our wholly-owned subsidiary, SVI Training Products, Inc. ("Training Products") to its former president for the sale price of \$180,000 plus earn-out payments equal to 20% of the total gross revenues of Training Products in each of its next two fiscal years, to the extent the revenues in each of those years exceed certain targets. We received a promissory note for the amount of \$180,000 and the earn-out payments, if any, will be made in quarterly installments following each fiscal year, bearing an annual interest rate of 5%. The sale of the Training Products subsidiary resulted in a loss of \$129,000, net of estimated income taxes, which was accrued for at March 31, 2003. The operating results of Training Products for the prior periods are restated as discontinued operations. The note has a balance of \$162,000 as of February 5, 2004.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, based on

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

historical experience, and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect significant judgments and estimates used in the preparation of our consolidated financial statements:

- o REVENUE RECOGNITION. Our revenue recognition policy is significant because our revenue is a key component of our results of operations. In addition, our revenue recognition determines the timing of certain expenses such as commissions and royalties. We follow specific and detailed guidelines in measuring revenue; however, certain judgments affect the application of our revenue policy.

We license software under non-cancelable agreements and provide related services, including consulting, training, customization of software and customer support. We recognize revenue in accordance with Statement of Position 97-2 (SOP 97-2), Software Revenue Recognition, as amended and interpreted by Statement of Position 98-9, Modification of SOP 97-2, Software Revenue Recognition, with respect to certain transactions, as well as Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants.

Software license revenue, including third party license revenues or partner products, is generally recognized when a license agreement has been signed, the software product has been delivered, there are no uncertainties surrounding product acceptance, the fees are fixed and determinable, and collection is considered probable. If a software license contains an undelivered element, the fair value of the undelivered element is deferred and the revenue recognized once the element is delivered. We can establish vendor specific objective evidence ("VSOE") for all elements and not just undelivered elements. The undeliverable elements are primarily training, consulting and maintenance services. VSOE of fair value for training and consulting services is based upon hourly rates charged when those services are sold separately. VSOE of fair value for maintenance is the price the customer will be required to pay when it is sold separately (that is, the renewal rate). In addition, if a software license contains contingencies, such as specific customer acceptance criteria, right of return or a cancellation right, the software revenue is recognized upon the later of customer acceptance or the expiration of the acceptance period or cancellation right. Typically, payments for our software licenses are due in installments within twelve months from the date of delivery. Where software license agreements call for payment terms of twelve months or more from the date of delivery, revenue is recognized as payments become due and all other conditions for revenue recognition have been satisfied. Deferred revenue consists primarily of prepaid maintenance support revenues, prepaid services revenue and deferred licenses.

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

Consulting services are separately priced, are generally available from a number of suppliers, and are not essential to the functionality of our software products. Consulting services, which include project management, system planning, design and implementation, customer configurations, and training are billed on both an hourly basis and under fixed price contracts. Consulting services revenue billed on an hourly basis is recognized as the work is performed. Under most fixed price contracts, consulting services revenue is recognized using the percentage of completion method of accounting by relating hours incurred to date to total estimated hours at completion. In instances where our fixed price contracts require the achievement of certain milestones, the milestones are agreed with the customer and revenues are recognized only when the milestones are delivered and accepted by the customer.

Customization of software is billed on both an hourly basis and under fixed price contracts. Customization services billed on an hourly basis are recognized as the work is performed. Under most fixed price contracts, customization services revenue is recognized using the percentage of completion method of accounting by relating hours incurred to date to total estimated hours at completion. In instances where our fixed price contracts require the achievement of certain milestones, the milestones are agreed with the customer and revenues are recognized only when the milestones are delivered and accepted by the customer.

Customer support services include post contract support and the rights to unspecified upgrades and enhancements. Maintenance revenues from ongoing customer support services are billed on a monthly basis and recorded as revenue in the applicable month, or on an annual basis with the revenue being deferred and recognized ratably over the maintenance period. If an arrangement includes multiple elements, the fees are allocated to the various elements based upon vendor-specific objective evidence of fair value.

- o ACCOUNTS RECEIVABLE. We typically extend credit to our customers. Software licenses are generally due in installments within twelve months from the date of delivery. Billings for customer support and consulting services performed on a time and material basis are due upon receipt. From time to time software and consulting services are provided under fixed price contracts where the revenue is only recognized and the payments are only due upon customer acceptance and the achievement of certain milestones. Management estimates the probability of collection of the receivable balances and provides an allowance for doubtful accounts based upon an evaluation of our customers' ability to pay and general economic conditions.
- o VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS AND GOODWILL. For fiscal 2003, we have adopted SFAS 142 resulting in a change in the way we value long-term intangible assets and

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

goodwill. We completed the initial transitional analysis of goodwill impairment as of April 1, 2002 and recorded an impairment of \$0.6 million as a cumulative effect of a change in accounting principle in the first quarter of fiscal 2003. We no longer amortize goodwill, but instead test goodwill for impairment on an annual basis or more frequently if certain events occur. Goodwill is to be measured for impairment by reporting units, which currently consist of our operating segments. At each impairment test for a business unit, we are required to compare the carrying value of the business unit to the fair value of the business unit. If the fair value exceeds the carrying value, goodwill will not be considered impaired.

22

If the fair value is less than the carrying value, we will perform a second test comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. The difference, if any, between the carrying amount of that goodwill and the implied fair value will be recognized as an impairment loss, and the carrying amount of the associated goodwill will be reduced to its implied fair value. These tests require us to make estimates and assumptions concerning prices for similar assets and liabilities, if available, or estimates and assumptions for other appropriate valuation techniques.

For our intangible assets with finite lives, including our capitalized software and non-compete agreements, we assess impairment at least annually or whenever events and circumstances suggest the carrying value of an asset may not be recoverable based on the net future cash flows expected to be generated from the asset on an undiscounted basis. When we determine that the carrying value of intangibles with finite lives may not be recoverable, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model.

RECENT ACCOUNTING PRONOUNCEMENTS

A number of new pronouncements have been issued for future implementation as discussed in the footnotes to our interim financial statements (see Note 12). As discussed in the notes to the interim financial statements, the implementation of some of these new pronouncements is not expected to have a material effect on our financial position or results of operations.

THREE MONTHS ENDED DECEMBER 31, 2003 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2002

REVENUES

Product revenues increased \$0.1 million, or 2%, to \$4.2 million in the quarter ended December 31, 2003 from \$4.1 million in the quarter ended December 31, 2002, primarily due to a \$1.5 million increase in sale of partner products, increase of \$0.1 million of maintenance revenues, offset by a decrease of \$1.6 million of company license sales. Services revenues decreased by \$2.3 million,

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

or 77% to \$0.7 million in the quarter ended December 31, 2003 from \$3.0 million in the quarter ended December 31, 2002 primarily due to a \$2.2 million decrease from Toys R Us., Inc. "(Toys)". Toys revenue in fiscal 2004 consisted primarily of implementation services. Toys had been a major customer since fiscal 2000 and terminated its contract in third quarter of fiscal 2004. As we don't anticipate additional material Toys revenue in the near future, the loss of Toys will have a significant impact on future revenues as we attempt to replace those revenues with revenues generated from new customers. Total revenues decreased \$2.2 million, or 31%, to \$4.9 million in the quarter ended December 31, 2003 from \$7.1 million in the quarter ended December 31, 2002 due to the above factors. Excluding Toys revenues of \$0 and \$2.2 million in the quarter ended December 31, 2003 and December 31, 2002, respectively, total revenues remained flat at \$4.9 million for the quarter ended December 31, 2003 and the quarter ended December 31, 2002.

COST OF REVENUES/GROSS PROFIT

Cost of revenues decreased by \$0.8 million, or 28%, to \$2.1 million in the quarter ended December 31, 2003 from \$2.9 million in the quarter ended December 31, 2002. Cost of product revenues increased by \$0.4 million, or 33%, to \$1.6 million in the quarter ended December 31, 2003 from \$1.2 million in the quarter ended December 31, 2002. Cost of services revenue decreased \$1.3 million, or 76%, to \$0.4 million in the quarter ended December 31, 2003 from \$1.7 million in the quarter ended December 31, 2002. Total gross profit decreased \$1.4 million, or 33%, to \$2.8 million in the quarter ended December 31, 2003 from \$4.2 million in the quarter ended December 31, 2002. Total gross profit was 58% and 59% for the quarter ended December 31, 2003 and the quarter ended December 31, 2002, respectively. Gross profit on products was 61% and 72% for the quarter ended December 31, 2003 and the quarter ended December 31, 2002, respectively, while gross profit on services was 36% and 43% for the quarter ended December 31, 2003 and the quarter ended December 31, 2002, respectively. Amortization of capitalized software included in cost of product revenues decreased to \$0.6 million in the quarter ended December 31, 2003 from \$0.7 million in the quarter ended December 31, 2002. The decrease in gross margin for product revenues is due primarily to a \$1.5 million increase in sale of partner products in the quarter ended December 31, 2003 compared to the quarter ended December 31, 2002, as partner products typically carry lower margins than company licenses. The decrease in gross margin on services was due to a large decrease in services and modification revenues which was not offset by decreased cost of services.

23

APPLICATION DEVELOPMENT EXPENSE

Application development expense decreased by \$0.3 million, or 43%, to \$0.4 million in the quarter ended December 31, 2003 from \$0.7 million in the quarter ended December 31, 2002. The decrease is primarily due to capitalizing \$0.8 million development costs for new products. We've made significant investments in our new products in the current year. We anticipate these new products will be launched during the second half of the fiscal 2004. In the prior comparative period, research and development efforts were spent on enhancing existing products.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization remained at \$0.3 million in the quarter ended

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

December 31, 2003 and the quarter ended December 31, 2002.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased by \$0.1 million, or 4%, to \$2.8 million in the three months ended December 31, 2003 from \$2.7 million in the three months ended December 31, 2002. The increase is due to increasing efforts and spending in marketing and sales activities, public and investor communications and professional fees.

INCOME (LOSS) FROM OPERATIONS

Operating loss from continuing operations, which included depreciation and amortization expense, was \$0.6 million for the quarter ended December 31, 2003, compared to an operating profit of \$0.6 million for the quarter ended December 31, 2002.

INTEREST EXPENSE

Interest expense was \$0 and \$209,000 in the quarters ended December 31, 2003 and 2002, respectively. The decrease is mainly due to no interest-bearing debts outstanding in the quarter ended December 31, 2003.

PROVISION FOR INCOME TAXES

Provision for income taxes for the quarters ended December 31, 2003 and 2002 are benefits of \$19,000 and \$1,000, respectively.

CUMULATIVE PREFERRED DIVIDENDS

Cumulative dividends on the outstanding Series A Preferred attributable to the quarter ended December 31, 2003 and 2002 were \$0.2 million and \$0.3 million, respectively.

NINE MONTHS ENDED DECEMBER 31, 2003 COMPARED TO NINE MONTHS ENDED DECEMBER 31, 2002

REVENUES

Product revenues increased \$1.0 million, or 12%, to \$9.2 million in the nine months ended December 31, 2003 from \$8.2 million in the nine months ended December 31, 2002, primarily due to a \$2.0 million increase from the sale of partner products, a \$0.2 million increase in maintenance revenues, offset by a \$1.3 million decrease in company license revenues. Services revenues decreased by \$3.7 million, or 49% to \$3.9 million in the nine months ended December 31, 2003 from \$7.6 million in the nine months ended December 31, 2002 primarily due to a \$3.8 million decrease from Toys R Us., Inc. "(Toys)". Toys revenue in fiscal 2004 consisted primarily of implementation services. Toys had been a major customer since fiscal 2000 and terminated its contract in third quarter of fiscal 2004. As we don't anticipate additional material Toys revenue in the near future, the loss of Toys will have a significant impact on future revenues as we attempt to replace those revenues with revenues generated from new customers. Total revenues decreased \$2.7 million, or 17%, to \$13.1 million in the nine months ended December 31, 2003 from \$15.8 million in the nine months ended

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

December 31, 2002 due to the above factors. Excluding Toys revenues of \$1.5 million and \$5.3 million in the nine months ended December 31, 2003 and December 31, 2002, respectively, total revenues were \$11.6 million for the nine months ended September 30, 2003 compared to \$10.5 million in the nine months ended December 31, 2002, a 10% increase

24

COST OF REVENUES/GROSS PROFIT

Cost of revenues decreased by \$2.1 million, or 26%, to \$6.0 million in the nine months ended December 31, 2003 from \$8.0 million in the nine months ended December 31, 2002. Cost of product revenues increased by \$0.6 million, or 18%, to \$4.0 million in the nine months ended December 31, 2003 from \$3.4 million in the nine months ended December 31, 2002. Cost of services revenue decreased \$2.7 million, or 59%, to \$1.9 million in the nine months ended December 31, 2003 from \$4.6 million in the nine months ended December 31, 2002. Total gross profit decreased \$0.6 million, or 8%, to \$7.2 million in the nine months ended December 31, 2003 from \$7.8 million in the nine months ended December 31, 2002. Total gross margin was 55% and 49% for the nine months ended December 31, 2003 and December 31, 2002, respectively. Gross margin on products was 57% and 59% for the nine months ended December 31, 2003 and December 31, 2002, respectively, while gross margin on services was 51% and 39% for the nine months ended December 31, 2003 and December 31, 2002, respectively. Amortization of capitalized software included in cost of product revenues decreased to \$1.9 million in the nine months ended December 31, 2003 from \$2.2 million in the nine months ended December 31, 2002. The decrease in gross margin for product revenues is due primarily to a \$2.0 million increase in sale of partner products, which carry lower margins than company license revenues, a decrease of \$1.3 million in company licenses, offset by a decrease of \$0.4 million in amortization of capitalized software costs in the nine months ended December 31, 2003 compared to the nine months ended December 31, 2002. The decrease in gross margin on services was due to a large decrease in services and modification revenues which was not offset by decreased cost of services revenues.

APPLICATION DEVELOPMENT EXPENSE

Application development expense decreased by \$1.8 million, or 62%, to \$1.1 million in the nine months ended December 31, 2003 from \$2.9 million in the nine months ended December 31, 2002. The decrease is primarily due to capitalizing \$2.6 million development costs for new products. We've made significant investments in our new products in the first nine months of the current year. We anticipate these new products will be launched during the last quarter of the fiscal 2004 and first quarter of the fiscal 2005. In the prior comparative period, research and development efforts were spent on enhancing existing products and properly charged to expense.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased by \$0.1 million, or 11%, to \$0.8 million in the nine months ended December 31, 2003 from \$0.9 million in the nine months ended December 31, 2002. The decrease is mainly due to full depreciation of certain fixed assets.

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased by \$2.1 million, or 32%, to \$8.6 million in the nine months ended December 31, 2003 from \$6.5 million in the nine months ended December 31, 2002. The first nine months of fiscal 2003 included a \$0.6 million reversal of excess amount accrued in prior periods for a litigation settlement. In addition, much of the fiscal 2004 was spent building infrastructure, developing our sales organization and increasing marketing efforts.

INCOME (LOSS) FROM CONTINUING OPERATIONS

Income (loss) from continuing operations, which included depreciation and amortization expense, was a loss of \$3.3 million for the nine months ended December 31, 2003, compared to a loss of \$2.5 million for the comparable period in the prior year.

INTEREST EXPENSE

Interest expense increased by \$0.2 million, or 13%, to \$1.8 million in the nine months ended December 31, 2003 from \$1.6 million in the nine months ended December 31, 2002. The increase is due primarily to a \$0.6 million increase in amortization of debt discount and beneficial conversion, offset by \$0.3 million decrease in interest expense. .

25

PROVISION FOR INCOME TAXES

Provision for income taxes represents \$0.6 million income tax refund and \$0.1 million provision for state income taxes in the nine months ended December 31, 2003. The income tax refund of \$0.6 million at December 31, 2003 results from amending prior years' income tax returns to carry back net operating losses incurred in the past two years.

CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE

Pursuant to SFAS 142, we completed the transitional analysis of goodwill impairment as of April 1, 2002 and recorded an impairment of \$0.6 million as the cumulative effect of a change in accounting principle in the quarter ended June 30, 2002. We also evaluated the remaining useful lives of our intangibles in the quarter ended June 30, 2002 and no adjustments have been made to the useful lives of our intangible assets. There have been no such charges in the quarter ended June 30, 2003.

CUMULATIVE PREFERRED DIVIDENDS

Cumulative dividends on the outstanding Series A Preferred attributable to the nine months ended December 31, 2003 and 2002 were \$0.7 million and \$0.8 million, respectively.

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOWS

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

During the nine months ended December 31, 2003, we financed our operations using cash on hand, internally generated cash, proceeds from the sale of common stock and proceeds from sale of convertible debentures. At December 31, 2003 and March 31, 2003, we had cash of \$5.1 million and \$1.3 million, respectively.

Operating activities used cash of \$5.4 million in the nine months ended December 31, 2003 and \$1.3 million in the nine months ended December 31, 2002. Cash used for operating activities in the nine months ended December 31, 2003 resulted from \$4.7 million net loss, \$2.6 million increase in accounts receivable and other receivables and \$3.7 million decrease in accounts payable and accrued expenses; offset in part by \$2.7 million of non-cash depreciation and amortization, \$1.7 million increase in deferred revenue and \$1.5 million in amortization of debt discount and conversion option.

Investing activities used cash of \$3.3 million in the nine months ended December 31, 2003 and \$0.1 million in the nine months ended December 31, 2002. Cash used for investing activities in the current quarter was primarily for capitalization of \$2.6 million software development costs, \$0.4 million purchase of capitalized software and \$0.3 million purchases of furniture and equipment.

Financing activities provided cash of \$12.5 million and \$0.8 million in the nine months ended December 31, 2003 and 2002, respectively. The financing activities in the nine months ended December 31, 2003 included net proceeds of \$12.0 million from the sale of common stock and \$0.7 million from the issuance of convertible debentures.

Accounts receivable increased to \$5.3 million at December 31, 2003 from \$4.0 million at March 31, 2003. The increase is primarily due to current receivables for semi-annual maintenance contracts billed in the quarter ended December 31, 2003.

We believe that our cash and cash equivalent and funds generated from operations will provide adequate liquidity to meet our normal operating requirements for at least the next twelve months. Our future capital requirements depend on many factors, including our application development, sales and marketing activities. In addition, we have incurred losses for the last three fiscal years. In the next twelve months, we anticipate raising additional capital through public or private equity or debt financings. In the long-term, we anticipate that cash from operations will be sufficient to provide liquidity for our normal operating requirements. As such, we do not know whether additional financing will be available when needed, or available on terms acceptable to us. We may raise capital through public or private equity or debt financings. If we are unable to raise the needed funds, we may be forced to curtail some or all of our activities and we may not be able to grow.

FINANCING TRANSACTIONS

In June 2003, we sold various institutional investors ("June 2003 Institutional Investors") 5,275,000 shares of common stock at a per share price of \$1.50 for an aggregate purchase price of \$7.9 million. In connection with this financing, we paid Roth Capital Partners, LLC ("Roth Capital"), as placement agent, cash compensation of 8% of the proceeds and issued a warrant to purchase 527,500

Edgar Filing: ISLAND PACIFIC INC - Form 10-Q/A

shares of common stock at an exercise price of \$1.65 per share, with a fair market value of \$859,000. We also issued warrants to purchase 375,000 shares of common stock at an exercise price of \$1.65, with a fair market value of \$620,000, to certain holders of our 9% convertible debentures in order to obtain their requisite consents and waivers of rights they possessed to participate in the financing. Pursuant to a registration rights agreement, we filed a registration statement respecting the shares sold to the June 2003 Institutional Investors and common stock underlying the warrants issued in connection with this transaction. The registration statement was declared effective on September 26, 2003 by the SEC.

On November 7, 2003, we sold various institutional investors ("November 2003 Institutional Investors") 3,180,645 shares of common stock at a price of \$1.55 per share for an aggregate purchase price of \$4.9 million. In connection with this financing, we paid Roth Capital, as placement agent, compensation of \$179,000 in cash and 115,226 shares of our common stock and issued a five-year warrant to purchase 282,065 shares of our common stock at an exercise price of \$1.71 per share, with a fair market value of \$388,000. Pursuant to a registration rights agreement, we filed a registration statement respecting to the shares sold to the November 2003 Institutional Investors and common stock underlying the warrant issued in connection with this transaction. This registration statement was declared effective on February 3, 2004.

INDEBTEDNESS

UNION BANK

Pursuant to the Discounted Loan Payoff Agreement dated March 31, 2003, we issued to Union Bank of California a \$500,000 unsecured, non-interest be