ALANCO TECHNOLOGIES INC
Form 10QSB
February 14, 2005

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

X QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2004

____TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from _____________ to ____________

Commission file number 0-9347

ALANCO TECHNOLOGIES, INC.
(Exact name of small business issuer as specified in its charter)

Arizona
(State or other jurisdiction of incorporation or organization)

86-0220694
(I.R.S. Employer Identification No.)

15575 N. 83rd Way, Suite 3, Scottsdale, Arizona 85260
(Address of principal executive offices) (Zip Code)

(480) 607-1010
(Issuer's telephone number)

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

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

As of February 11, 2005 there were 25,489,200 shares, net of treasury shares, of common stock outstanding.

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

Forward-Looking Statements: Some of the statements in this Form 10-QSB Quarterly Report, as well as statements by the Company in periodic press releases, oral statements made by the Company's officials to analysts and shareholders in the course of presentations about the Company, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words or phrases denoting the anticipated results of future events such as "anticipate," "believe," "estimate," "will likely," "are expected to," "will continue," "project," "trends" and similar expressions that denote uncertainty are intended to identify such forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Such factors include, among other things, (i) general economic and business conditions; (ii) changes in industries in which the Company does business; (iii) the loss of market share and increased competition in certain markets; (iv) governmental regulation including environmental laws; and (v) other factors over which the company has little or no control.

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ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2004 AND JUNE 30, 2004

	Dec 31, 2004	June 30, 2004
ASSETS	(unaudited)	
CURRENT ASSETS		
Cash and Cash Equivalents	$ 1,468,700	$ 1,975,600
Accounts receivable, net	991,600	657,200
Inventories, net	2,260,400	2,282,300
Cost and est earnings in excess of billings on uncompleted contracts	55,500	-
Prepaid expenses and other current assets	185,900	110,600
Total Current Assets	4,962,100	5,025,700
PROPERTY, PLANT AND EQUIPMENT, NET	265,000	247,500
OTHER ASSETS		
Goodwill and other intangible assets, net	5,939,900	6,048,000
Long-term notes receivable, net	13,000	68,000
Net assets held for sale	126,400	156,100
Other assets	35,300	40,600
Total Other Assets	6,114,600	6,312,700
TOTAL ASSETS	$ 11,341,700	$ 11,585,900
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 1,515,900	$ 1,246,500
Notes payable and capital leases, current	501,700	5,200
Billings in excess of cost and est earnings on uncompleted contracts	-	25,800
Deferred revenue, current	150,300	27,200
Total Current Liabilities	2,167,900	1,304,700
LONG TERM LIABILITIES		
Notes payable and capital leases, long term	314,100	814,100

TOTAL LIABILITIES	2,482,000	2,118,800
Preferred Stock - Series B, 63,200 and 60,200 shares issued and outstanding, respectively	632,800	602,800
SHAREHOLDERS' EQUITY		
Preferred Stock - Series A Convertible, 2,624,600 and 2,476,800 shares issued and outstanding, respectively	3,177,900	2,956,100
Common Stock, 25,478,500,and 23,232,800 shares outstanding, net of 500,000 shares of Treasury Stock	70,132,000	68,959,600
Accumulated deficit	(65,083,000)	(63,051,400)
Total shareholders' equity	8,226,900	8,864,300
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$ 11,341,700	$ 11,585,900

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.

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

	2004	2003
NET SALES	$ 2,085,500	$ 1,234,100
Cost of goods sold	1,402,400	755,900
GROSS PROFIT	683,100	478,200
Selling, general and administrative expense	1,548,900	1,144,700
OPERATING LOSS	(865,800)	(666,500)
OTHER INCOME & EXPENSES		
Interest expense, net	(11,200)	(32,000)
Other income, net	5,800	37,100
LOSS FROM OPERATIONS	(871,200)	(661,400)
Preferred stock dividends - in kind	(15,000)	(14,500)
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	$ (886,200)	$ (675,900)

NET LOSS PER SHARE - BASIC AND DILUTED		
- Net loss attributable to common shareholders	$ (0.03)	$ (0.04)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	25,416,700	16,402,100

See accompanying notes to the consolidated financial statements

ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED DECEMBER 31, (Unaudited)

	2004	2003
NET SALES	$ 3,822,700	$ 2,271,500
Cost of goods sold	2,518,200	1,400,600
GROSS PROFIT	1,304,500	870,900
Selling, general and administrative expense	3,067,600	2,264,500
OPERATING LOSS	(1,763,100)	(1,393,600)
OTHER INCOME & EXPENSES		
Interest expense, net	(27,600)	(114,700)
Other income, net	10,800	39,200
LOSS FROM OPERATIONS	(1,779,900)	(1,469,100)
Preferred stock dividends - in kind	(251,700)	(27,000)
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	$ (2,031,600)	$ (1,496,100)
NET LOSS PER SHARE - BASIC AND DILUTED		
- Net loss attributable to common shareholders	$ (0.08)	$ (0.09)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	24,887,000	15,789,200

See accompanying notes to the consolidated financial statements

ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN CERTAIN SHAREHOLDERS' EQUI
STOCK ACCOUNTS FOR THE SIX MONTHS ENDED DECEMBER 31, 2004 (Unaudit

	Common Stock		Preferred Stock - Ser A		Preferred S
	Shares	Dollars	Shares	Dollars	Shares
Balances at 06/30/04	23,732,800	$ 69,334,700	2,476,800	$ 2,956,100	60,200
Preferred dividends in kind	-	-	147,800	221,800	3,000
Shares issued for services	57,500	59,900	-	-	-
Options and Warrants exercised	2,188,200	1,145,600	-	-	-
Other	-	(33,200)	-	-	-
Balances at 12/31/04	25,978,500	$ 70,507,000	2,624,600	$ 3,177,900	63,200

See accompanying notes to the consolidated fin

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ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
FOR THE SIX MONTHS ENDED DECEMBER 31,

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss from operations	$ (1,779,900)	$ (1,469,100)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	168,100	172,800
Stock and warrants issued for services	59,900	60,200
Income from assets held for sale	(10,800)	(8,600)
Gain on disposal of asset	-	(1,000)
Changes in:		
Accounts receivable, net	(334,400)	(100)
Inventories, net	21,900	366,700)
Costs in excess of billings and estimated earnings on uncompleted contracts	(55,500)	-
Prepaid expenses and other current assets	(75,300)	(76,800)
Accounts payable and accrued expenses	269,400	185,500)
Deferred revenue	123,100	(16,600)
Billings and estimated earnings in excess of costs on uncompleted contracts	(25,800)	-
Other assets	5,300	6,100
Net cash used in operating activities	(1,634,000)	(885,300)

CASH FLOWS FROM INVESTING ACTIVITIES		
Net cash from assets held for sale	40,500	43,900
Collection of notes receivable	55,000	142,500
Purchase of property, plant and equipment	(75,500)	(14,000)
Proceeds from the sale of property, plant and equipment	-	5,200
Goodwill, acquisition	-	(5,000)
Patent renewal and other	(1,800)	-
Net cash provided by investing activities	18,200	172,600

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.

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

	2004	2003
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances on borrowings	-	1,205,000
Repayment on borrowings	(3,500)	(1,780,800)
Subscriptions receivable	-	899,200
Net proceeds from sale of Preferred Stock	-	102,400
Net proceeds from sale of Common Stock	1,112,400	1,248,300
Net cash provided by financing activities	1,108,900	1,674,100
NET DECREASE IN CASH	(506,900)	(38,600)
CASH AND CASH EQUIVALENTS, beginning of period	1,975,600	97,700
CASH AND CASH EQUIVALENTS, end of period	$ 1,468,700	$ 59,100
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION		
Net cash paid during the period for interest	$ 16,700	$ 114,700
Non-Cash Activities:		
Value of stocks and warrants issued for services	$ 59,900	$ 60,200
Series B preferred stock dividend, in kind	$ 30,000	$ 27,000
Series A preferred stock dividend, in kind	$ 221,800	$ -
Value of treasury stock redeemed in		

preferred stock and warrant issuance	$ -	$ 198,300
Value of treasury stock cancelled	$ -	$ 1,907,200
Conversion of debt to equity	$ -	$ 250,000

See accompanying notes to the consolidated financial statements

ALANCO TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED DECEMBER 31, 2004

Note A - Basis of Presentation and Recent Accounting Pronouncements

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

The unaudited condensed consolidated balance sheet as of December 31, 2004 and the related unaudited condensed consolidated statements of operations and cash flows for the three months and six months ended December 31, 2004 presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions to Form 10-QSB. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. In our opinion, the accompanying condensed consolidated financial statements include all adjustments necessary for a fair presentation of such condensed consolidated financial statements. Such necessary adjustments consist of normal recurring items and the elimination of all significant intercompany balances and transactions.

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

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

All stock options issued to employees have an exercise price not less than the fair market value of the Company's Common Stock on the date of grant. In accordance with accounting for such options utilizing the intrinsic value method under APB 25, there is no related compensation expense recorded in the Company's financial statements for the six months ended December 31, 2004 and 2003. Had compensation cost for stock-based compensation been determined based on the fair value of the options at the grant dates consistent with the method of SFAS 123, the Company's net loss and loss per share would have been increased to the pro forma amounts presented below.

ALANCO TECHNOLOGIES, INC.

	6 months ended December 31, 2004	2003
Net loss, as reported	$ (2,031,600)	$ (1,496,100)
Add: Stock-based Employee compensation expense included in reported income, net of related tax effects	-	-
Deduct: Total stock-based Employee compensation expense determined under fair value based methods for all awards, net of related tax effects	$ (43,500)	$ (245,700)
Pro forma net loss	$ (2,075,100)	$(1,741,800)
Net loss per common share, basic and diluted as reported	$ (0.08)	$ (0.09)
Pro forma	$ (0.08)	$ (0.11)
Weighted average common shares	24,887,000	16,402,100

During the six months ended December 31, 2004, the Company granted employee stock options to purchase 75,000 shares of the Company's Class A Common Stock at an average purchase price of $1.20, market price on date granted. The fair value of option grants is estimated as of the date of grant, in accordance with SFAS 123, utilizing the Black-Scholes option-pricing model, with the assumptions substantively utilized in the year-end financial statements.

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

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

In December 2004, the FASB issued Statement No. 153 ("SFAS 153"), "Exchanges of

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

In December 2004, the FASB issued Statement No. 123R ("SFAS 123R"), "Share-Based Payment". This Statement focuses primarily on accounting for transactions in

which an entity obtains employee services in share-based payment transactions. It requires that the fair-value-based method be used to account for these transactions for all public entities. This Statement is effective for small business issuers for the first reporting period after December 15, 2005 and will effect any stock based compensation for options issued after that date, or not vested as of that date..

Note B - Inventories

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

	December 31, 2004	June 30, 2004
	(unaudited)	
Raw materials and purchased parts	$ 2,186,000	$ 1,894,700
Work-in-progress	141,700	198,300
Finished goods	203,700	279,300
	2,531,400	2,372,300
Less reserves for obsolescence	(271,000)	(90,000)
	$ 2,260,400	$ 2,282,300

Note C - Contracts In Process

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

	December 31, 2004	June 30, 2004
	(unaudited)	
Costs incurred on uncompleted contracts	$ 240,200	$ 117,300
Estimated gross profit earned to date	168,000	58,200

Revenue earned to date	408,200	175,500
Less Billing to date	(352,700)	(201,300)
Costs and estimated earnings in excess of Billing (billing in excess of costs and earnings)	$ 55,500	$ (25,800)

Note D - Deferred Revenue

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

	December 31, 2004	June 30, 2004
	(unaudited)	
Extended warranty revenue	$ 150,300	$ 27,200
Less - current portion	(150,300)	(27,200)
	$ -	$ -

Note E - Loss Per Share

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

Diluted earnings per share are computed based on the weighted average number of shares of common stock and dilutive securities outstanding during the period. Dilutive securities are options and warrants that are freely exercisable into common stock at less than the prevailing market price. Dilutive securities are not included in the weighted average number of shares when inclusion would increase the earnings per share or decrease the loss per share. As of December 31, 2004 there were 3,803,750 potentially dilutive securities outstanding.

Note F - Equity

During the six months ended December 31, 2004, the Company issued a total of 2,245,700 shares of the Company's Class A Common Stock. Included were 2,188,200 shares issued upon exercise of outstanding warrants and options generating $1,145,600 in proceeds to the Company. The balance of 57,500 shares, valued at $59,900 fair market value, were issued in exchange for services rendered to the Company.

The Company declared dividends on the Company's preferred shares during the six months and paid the dividends-in-kind through the issuance of 147,800 shares of Series A Preferred Stock valued at $221,800 and 3,000 shares of Series B Preferred Stock valued at $30,000. The Preferred Stock is more fully discussed in the Form-10KSB for the year ended June 30, 2004.

Note G –Industry Segment Data

Information concerning operations by industry segment follows (unaudited):

	Six Months Ended 12/31		Three Months Ended 12/31	
	2004	2003	2004	2003
Revenue				
Data Storage	$ 3,187,500	$ 2,246,700	$ 1,821,800	$ 1,211,300
RFID Technology	635,200	24,800	263,700	22,800
Total Revenue	3,822,700	2,271,500	2,085,500	1,234,100
Gross Profit				
Data Storage	1,047,000	863,900	567,100	468,000
RFID Technology	257,500	7,000	116,000	10,200
Total Gross Profit	1,304,500	870,900	683,100	478,200
Gross Margin				
Data Storage	32.8%	38.5%	31.1%	38.6%
RFID Technology	40.5%	28.2%	44.0%	44.7%
Overall Gross Margin	34.1%	38.3%	32.8%	38.7%
Selling, General & Administrative Expense				
Data Storage	878,500	822,100	433,300	404,000
RFID Technology	1,393,900	993,700	703,900	497,400
Total Segment Operating Expense	2,272,400	1,815,800	1,137,200	901,400
Operating Profit (Loss)				
Data Storage	168,500	41,800	133,800	64,000
RFID Technology	(1,136,400)	(986,700)	(587,900)	(487,200)
Corporate Expense	(795,200)	(448,700)	(411,700)	(243,300)
Operating Loss	(1,763,100)	(1,393,600)	(865,800)	(666,500)
Depreciation & Amortization				
Data Storage	8,000	15,500	4,400	7,500
RFID Technology	158,700	153,800	80,300	76,900
Corporate	1,400	3,500	700	1,100
Total Depreciation & Amortization	$ 168,100	$ 172,800	$ 85,400	$ 85,500

Note H – Related Party Transactions

The Company has a line of credit agreement ("Agreement"), more fully discussed in the Company's Form 10-KSB for the year ended June 30, 2004, with a private trust controlled by Mr. Donald Anderson, a greater than five percent stockholder and a member of the Company's Board of Directors.

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ALANCO TECHNOLOGIES, INC.

Note I - Line of Credit

At December 31, 2004, the Company had an outstanding balance of $500,000, which is presented as line of credit balance due. The balance is under a $1.3 million line of credit agreement with a private trust ("Lender"), entered into in June 2002 and modified in April and October of 2003. Under the Agreement, the Company must maintain a minimum balance due under the line of at least $500,000 through the July 1, 2005 expiration date. At December 31, 2004, the Company had $800,000 available under the line of credit agreement.

Note J - Litigation

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

Note K - Subsequent Events

In January 2005, Arraid, Inc., a wholly owned subsidiary in the Company's Data Storage segment, was awarded a $655,000 contract by the United States Air Force to provide Arraid's proprietary emulation module (AEM) disc drive replacements for ground-based testing equipment supporting the Cruise Missile Program. Arraid is scheduling this contract for completion during the second half of the current fiscal year ended June 30, 2005.

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

Except for historical information, the statements contained herein are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All such forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed or implied by those statements. These risks and uncertainties include, but are not limited to, the following factors: general economic and market conditions; reduced demand for information technology equipment; competitive pricing and difficulty managing product costs; development of new technologies which make the Company's products obsolete; rapid industry changes; failure by the Company's suppliers to meet quality or delivery requirements; the inability to attract, hire and retain key personnel; failure of an acquired business to further the Company's strategies; the difficulty of integrating an acquired business; undetected problems in the Company's products; the failure of the Company's intellectual property to be adequately protected; unforeseen litigation; the ability to maintain sufficient liquidity in order to support operations; the ability to maintain satisfactory relationships with lenders and to remain in compliance with financial loan covenants and other requirements under current banking agreements; and the ability to maintain satisfactory relationships with suppliers and customers.

General

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

Critical Accounting Policies and Estimates

Management's discussion and analysis of financial condition and results of operations are based upon the condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally

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

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

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

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

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

Results of Operations

(A) Three months ended 12/31/2004 versus 12/31/2003

Sales

Consolidated sales for the quarter ended December 31, 2004 was $2,085,500, compared to $1,234,100 for the comparable quarter of the previous year, an increase of $851,400, or 69%. The increase is attributed to sales increases in the Data Storage segment, which increased $610,500 to $1,821,800 in the current quarter from $1,211,300 reported for the three months ended December 31, 2003; and the RFID Technology segment, which reported a sales increase to $263,700 in the quarter ended December 31, 2004 compared to $22,800 for the comparable quarter in the prior fiscal year. The increase in Data Storage segment sales compared to the previous year resulted from increased demand for the Company's data storage products as companies increased technology expenditures in reaction to improving economic conditions. Sales of the RFID Technology segment increased due to system warranty revenue and revenue from the current contract in progress. The same quarter in the prior fiscal year had been negatively affected by prison contract and funding postponements caused by fiscal budgetary constraints.

Gross Profit and Operating Expenses

Gross profit generated during the quarter amounted to $683,100, an increase of $204,900, or 43%, when compared to the same quarter of the prior year. Gross margins decreased from 39% for the quarter ended

December 31, 2003 to 33 for the current quarter. The decrease in gross margin resulted primarily from a change in product mix to lower gross margin products in the Data Storage segment.

Selling, general and administrative expenses for the current quarter increased to $1,548,900, a $404,200 increase, or 35%, when compared to $1,144,700 incurred in the comparable quarter of fiscal year 2004. The major components of the increase in selling, general and administrative expense were increases of approximately $134,000 in legal expense related to the litigation in which the Company is currently involved (See Litigation Footnote), an increase in R&D expenditures of $100,000 related to new technology in the RFID Technology segment that reduced the value of existing inventory, increases in sales commissions related to Data Storage segment sales growth and TSI Technology segment's continued aggressive development in the core United States prison market.

Operating Loss

The Operating Loss for the quarter was ($865,800) compared to a loss of ($666,500) for the same quarter of the prior year, an increase of 30%. The increased loss resulted primarily from increased legal expenses and R&D expenditures for the current quarter compared to the comparable quarter of the prior fiscal year.

Interest and Dividends Expense

Interest expense for the quarter amounted to $11,200 compared to interest expense of $32,000 for the same quarter in the prior year. The interest expense reduction resulted from a decrease in average borrowing during the quarter accomplished by the Company's effort in raising additional working capital. The Company paid quarterly in-kind Series B Preferred Stock dividends with values of $15,000 and $14,500 in the quarters ended December 31, 2004 and 2003, respectively.

Net Loss Attributable to Common Stockholders

Net Loss Attributable to Common Stockholders for the quarter ended December 31, 2004 amounted to ($886,200), or ($.03) per share, compared to a loss of ($675,900), or ($.04) per share, in the comparable quarter of the prior year. Although the Company has shown improved operating results in its Data Storage segment and anticipates improved future operating results in its RFID Technology segment as the economy improves, actual results in both the Data Storage segment and the RFID Technology segment may be affected by unfavorable economic conditions and reduced capital spending budgets. If the economic conditions in the United States worsen or if a wider or global economic slowdown occurs, Alanco may experience a material adverse impact on its operating results and business conditions.

(B) Six months ended 12/31/2004 versus 12/31/2003

Sales

Consolidated Sales for the six months ended December 31, 2004 was $3,822,700, an increase of $1,551,200, or 68%, compared to $2,271,500 reported for the comparable period of the previous year. The increase is attributed to revenue increases in the Company's Data Storage segment which reported sales for the six months of $3,187,500, an increase of $940,800, or 42%, compared to $2,246,700 reported for the six months ended December 31, 2003, and the RFID Technology segment, which reported six months' sales of $635,200 compared to $24,800 for the comparable period in the prior fiscal year.

Gross Profit and Operating Expenses

Gross profit generated during the six months amounted to $1,304,500, an increase of $433,600, or 50% when compared to the same period of the prior year. Gross margins decreased from 38% for the six months ended December 31, 2003 to 34% for the current period. The decrease in gross margin resulted primarily from a change in product mix to lower gross margin products in the Data Storage segment.

Selling, general and administrative expenses for the six months ended December 31, 2004 increased to $3,067,600, a $803,100 increase, or 36%, when compared to $2,264,500 incurred in the comparable period of fiscal year 2004. The major components of the increase in selling, general and administrative expense were increases of approximately $303,000 in legal expense, an increase in R&D expenditures of $175,000 related to new technology in the RFID Technology segment that reduced the value of existing inventory, increases in sales commissions related to increases in Data Storage segment sales and TSI Technology segment's continued aggressive development in the core United States prison market, including the recently established lobbying activities in key states.

Operating Loss

The Operating Loss for the six-month period was ($1,763,100) compared to a loss of ($1,393,600) for the same six-month period of the prior fiscal year, an increase of 27%. The increased loss resulted from increased legal expenses and R&D expenditures for the current period compared to the comparable six-month period of the prior year.

Interest and Dividends Expense

Interest expense for the six months ended December 31, 2004 amounted to $27,600 compared to interest expense of $114,700 for the same six-month period in the prior year. The reduction in interest expense resulted from a decrease in average borrowing during the period accomplished by the Company's successful effort in raising additional working capital. The Company paid in-kind Preferred Stock dividends with values of $251,700 and $27,000 in the six months ended December 31, 2004 and 2003, respectively.

Net Loss Attributable to Common Stockholders

Net Loss Attributable to Common Stockholders for the six months ended December 31, 2004 amounted to ($2,031,600), or ($.08) per share, compared to a loss of ($1,496,100), or ($.09) per share, in the comparable period of the prior year. Although the Company has shown improved operating results in its Data Storage segment and anticipates improved future operating results in its RFID Technology segment as the economy improves, actual results in both the Data Storage segment and the RFID Technology segment may be affected by unfavorable economic conditions and reduced capital spending budgets. If the economic conditions in the United States worsen or if a wider or global economic slowdown occurs, Alanco may experience a material adverse impact on its operating results and business conditions.

Liquidity and Capital Resources

The Company's current assets at December 31, 2004 exceeded current liabilities by $2,794,200, resulting in a current ratio of 2.29 to 1. At June 30, 2004 the Company's current assets exceeded current liabilities by $3,721,000, reflecting a current ratio of 3.85 to 1. The decrease in the current ratio at December 31, 2004 when compared to June 30, 2004 resulted from losses incurred during the period and the reclassification of $500,000 credit line payable to current liabilities at December 31, 2004 from long-term notes payable at June 30, 2004. The reclassification was required to reflect the July 1, 2005 termination date of the existing line of credit agreement. Accounts receivable of $991,600 at December 31, 2004, reflects an increase of $334,400, or 50%, when compared to the $657,200 reported as consolidated accounts receivable at June 30, 2004. The accounts receivable balance at December 31, 2004 represented forty-seven days' sales in receivables compared to forty-eight days' sales at June 30, 2004.

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Consolidated inventories at December 31, 2004 amounted to $2,260,400, a decrease of $21,900, or 1%, when compared to $2,282,300 at June 30, 2004. The December 31, 2004 reflects an inventory turnover of 2.5 compared to 1.4 at June 30, 2004. Although the December 31, 2004 balance reflects only a slight decrease from the June 30, 2004 balance, it is a much larger increase when compared to inventory levels of prior reporting periods and reflects management's continued anticipated revenue increases for both the Data Storage segment and the RFID Technology segment.

At December 31, 2004, the Company had an outstanding balance of $500,000 under a $1.3 million formula-based revolving bank line of credit agreement with interest calculated at prime plus 4%. The line of credit agreement formula is based upon current asset values and is used to finance working capital. At December 31, 2004, the Company had $800,000 available under the line of credit. See Line of Credit Footnote I for additional discussion of the existing line of credit agreement.

Cash used in operations for the six-month period was $1,634,000, a decrease of $251,300 when compared to cash used in operations of $1,885,300 for the comparable period ended December 31, 2003. The decrease was due primarily to increases in accounts payable offset by an increase in loss from operations for the period.

During the six months ended December 31, 2004, the Company reported cash flows from investing activities of $18,200, including collecting $55,000 in notes receivable, purchasing $75,500 of additional equipment and raising $40,500 from the sale of assets held for sale. For the six months ended December 31, 2003, the Company reported $172,600 of cash flow from investing activities, including collecting notes receivable of $142,500, purchasing additional equipment in the amount of $14,000 and raising $49,100 from the sale of property, plant & equipment and assets held for sale.

Cash provided by financing activities for the six months ended December 31, 2004 consisted primarily of $1.1 million in proceeds received from the sale of common stock. Cash provided by financing activities during the same period in the prior fiscal year included the collection of subscription receivables in the amount of $899,200 and net proceeds from the sale of common and preferred stock of $1,350,700, offset by net repayment on borrowings during the period of $575,800.

The Company believes that additional cash resources may be required for working capital to achieve planned operating results for fiscal year 2005 and, if working capital requirements exceed current availability, the Company anticipates raising capital through additional borrowing or sale of stock. The additional capital would supplement the projected cash flows from operations and the line of credit agreement in place at December 31, 2004. If additional working capital was required and the Company was unable to raise the required additional capital, it may materially affect the ability of the Company to achieve its financial plan. See Footnote F - Equity for additional information related to working capital raised by the Company during the six months ended December 31, 2004, necessary to achieve planned operating results for the current fiscal year.

Item 3 - CONTROLS AND PROCEDURES

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

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

Since the date of the most recent evaluation of the Company's internal controls by the Chief Executive and Chief Financial Officers, there have been no significant changes in such controls or in other factors that could have significantly affected those controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II. OTHER INFORMATION

Item 1 - LEGAL PROCEEDINGS

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

Item 2. CHANGES IN SECURITIES

During the six months ended December 31, 2004, the Company issued 147,800 shares of Series A Preferred Stock and 3,000 Shares of Series B Preferred Stock as dividend in-kind payments, 2,188,200 shares of Class A Common Stock for the exercise of existing warrants and options and 57,500 shares of Common Stock for services rendered.

Item 6. EXHIBITS

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

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunder duly authorized.

ALANCO TECHNOLOGIES, INC.
(Registrant)

/s/ John A. Carlson
John A. Carlson
Executive Vice President and
Chief Financial Officer

EXHIBIT 31.1

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

I, Robert R. Kauffman, certify that:

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

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

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

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

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

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

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

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

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

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

Date: February 11, 2005

/s/ Robert R. Kauffman

Robert R. Kauffman
Chairman and Chief Executive Officer

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EXHIBIT 31.2

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

I, John A. Carlson, certify that:

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

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

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

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

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

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

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

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

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

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

Date: February 11, 2005
/s/ John A. Carlson

John A. Carlson
Executive Vice President and Chief Financial Officer

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EXHIBIT 32.1

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

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and accompanies this quarterly report of Form 10-QSB (the "Report") for the period ended December 31, 2004 of Alanco Technologies, Inc. (the "Issuer").

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

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

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

Dated: February 11, 2005

/s/ Robert R. Kauffman

Robert R. Kauffman
Chief Executive Officer

/s/ John A. Carlson

John A. Carlson
Chief Financial Officer