ALANCO TECHNOLOGIES INC
Form 10QSB
May 15, 2006

ALANCO TECHNOLOGIES, INC.

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

X QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2006

X TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT
For the transition period from ---------- to ----------

Commission file number 0-9347

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

Arizona
(State or other jurisdiction of incorporation or organization)

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

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

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

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

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

As of May 5, 2006 there were 31,265,200 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 MARCH 31, 2006 AND JUNE 30, 2005

	March 31, 2006	June 30, 2005
ASSETS	(unaudited)	
CURRENT ASSETS		
Cash and cash equivalents	$ 197,300	$ 737,300
Accounts receivable, net	925,400	1,091,400
Notes receivable, current	29,600	80,000
Inventories, net	2,252,900	1,902,600
Prepaid expenses and other current assets	545,100	378,200
Total current assets	3,950,300	4,189,500
PROPERTY, PLANT AND EQUIPMENT, NET	195,700	273,500
OTHER ASSETS		
Goodwill	5,356,300	5,356,300
Other intangible assets	394,600	560,700
Long-term notes receivable, net	3,500	8,000
Net assets held for sale	46,600	100,200
Other assets	47,500	55,700
Total other assets	5,848,500	6,080,900
TOTAL ASSETS	$ 9,994,500	$ 10,543,900

LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes payable, current portion	89,000	-
Accounts payable and accrued expenses	$ 1,494,100	$ 1,279,600
Billings in excess of cost and est earnings on uncompleted contracts	31,900	4,200
Deferred revenue, current	47,400	60,100
Total Current Liabilities	1,662,400	1,343,900
LONG-TERM LIABILITIES		
Notes payable, long-term	1,314,100	1,143,600
TOTAL LIABILITIES	2,976,500	2,487,500
Preferred Stock - Series B, 71,400 and 68,000 shares issued and outstanding, respectively	719,300	667,300
SHAREHOLDERS' EQUITY		
Preferred Stock - Series A Convertible, 3,122,900 and 2,781,200 shares issued and outstanding, respectively	3,925,200	3,412,700
Common Stock- 30,395,200 and 26,680,200 shares outstanding, net of 500,000 shares of Treasury Stock	73,774,500	71,714,600
Treasury Stock, at cost	(375,100)	(375,100)
Accumulated deficit	(71,025,900)	(67,363,100)
Total shareholders' equity	6,298,700	7,389,100
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$ 9,994,500	$ 10,543,900

See accompanying notes to the consolidated financial statements

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

	2006	2005
NET SALES	$ 1,466,200	$ 1,531,200
Cost of goods sold	914,700	975,300
GROSS PROFIT	551,500	555,900
Selling, general and administrative expense	1,580,100	1,712,200
OPERATING LOSS	(1,028,600)	(1,156,300)

OTHER INCOME & EXPENSES		
Interest expense, net	(23,700)	(11,200)
Other income, net	60,200	63,900
LOSS FROM OPERATIONS	(992,100)	(1,103,600)
Preferred stock dividends - paid in kind	(281,500)	(252,000)
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ (1,273,600)	$ 1,355,600)
NET LOSS PER SHARE - BASIC AND DILUTED		
- Net loss attributable to common shareholders	$ (0.04)	$ (0.05)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	30,111,900	25,514,500

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE NINE MONTHS ENDED MARCH 31, (Unaudited)

	2006	2005
NET SALES	$ 4,692,700	$ 5,353,900
Cost of goods sold	3,085,100	3,493,500
GROSS PROFIT	1,607,600	1,860,400
Selling, general and administrative expense	4,716,800	4,779,800
OPERATING LOSS	(3,109,200)	(2,919,400)
OTHER INCOME & EXPENSES		
Interest expense, net	(65,900)	(38,800)
Other income, net	76,900	74,700
LOSS FROM OPERATIONS	(3,098,200)	(2,883,500)
Preferred stock dividends - paid in kind	(564,600)	(503,700)
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ (3,662,800)	$ (3,387,200)
NET LOSS PER SHARE - BASIC AND DILUTED		
- Net loss attributable to common shareholders	(0.13)	$ (0.13)

WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	28,351,700	25,118,000

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE NINE MONTHS ENDED MARCH 31, 2006 (unaudited)

	COMMON STOCK		SERIES A PREFERRED STOCK		TREASURY STOCK		
	SHARES	AMOUNT	SHARES	AMOUNT	SHARES	AMOUNT	
Balances, June 30, 2005	27,180,200	$ 71,714,600	2,781,200	$ 3,412,700	500,000	$(375,100)	$
Exercise of options	140,000	53,600	-	-	-	-	
Exercise of warrants	1,850,000	1,135,000	-	-	-	-	
Shares issued for prepaid services	225,000	135,100	-	-	-	-	
Quarterly stock valuation	-	(64,700)	-	-	-	-	
Private Offering, net	1,500,000	830,000	-	-	-	-	
Preferred dividends, paid in kind	-	-	341,700	512,500	-	-	
Nasdaq Fees	-	(29,100)	-	-	-	-	
Net loss	-	-	-	-	-	-	
Balances, March 31, 2006	30,895,200	$ 73,774,500	3,122,900	$ 3,925,200	500,000	$(375,100)	$

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ALANCO TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED MARCH 31, (Unaudited)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss from operations	$ (3,098,200)	$ (2,883,500)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	301,200	257,300
Stock issued for services	51,100	73,300
Income from assets held for sale	(23,600)	(74,800)
Changes in:		
Accounts receivable, net	166,000	(396,300)

Inventories, net	(328,600)	24,700
Prepaid expenses and other current assets	(147,600)	(64,200)
Other assets	8,200	5,300
Accounts payable and accrued expenses	214,500	316,700
Deferred revenue	(12,700)	78,000
Billings and estimated earnings in excess of costs on uncompleted contracts	27,700	(25,800)
Net cash used in operating activities	(2,842,000)	(2,689,300)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net cash from assets held for sale	77,200	123,400
Collection of notes receivable, net	54,900	12,000
Purchase of property, plant and equipment	(80,000)	(101,700)
Patent renewal and other	900	(1,800)
Net cash provided by investing activities	53,000	31,900

See accompanying notes to the consolidated financial statements

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

	2006	2005
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances on borrowings	$ 495,500	$ -
Repayment on borrowings	(236,000)	(5,200)
Net proceeds from sale of equity transactions	1,989,500	1,300,000
Net cash provided by financing activities	2,249,000	1,294,800
NET (DECREASE) IN CASH	(540,000)	(1,362,600)
CASH AND CASH EQUIVALENTS, beginning of period	737,300	1,975,600
CASH AND CASH EQUIVALENTS, end of period	$ 197,300	$ 613,000
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION		
Net cash paid during the period for interest	$ 47,400	$ 38,800
Non-Cash Activities:		
Value of stocks and warrants issued for services and prepayments	$ 135,100	$ 336,800

Valuation adjustment	$ (64,700)	$ -
Value of warrants issued for credit line extension	$ -	$ 23,300
Series B preferred stock dividend, paid in kind	$ 52,000	$ 47,200
Series A preferred stock dividend, paid in kind	$ 512,500	$ 456,600

See accompanying notes to the consolidated financial statements

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ALANCO TECHNOLOGIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MARCH 31, 2006

Note A - Basis of Presentation and Recent Accounting Pronouncements

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

The unaudited condensed consolidated balance sheet as of March 31, 2006, the related unaudited condensed consolidated statements of operations, changes in shareholders' equity and cash flows for the nine months ended March 31, 2006 presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions to Form 10-QSB. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. In our opinion, the accompanying condensed consolidated financial statements include all adjustments necessary for a fair presentation of such condensed consolidated financial statements. Such necessary adjustments consist of normal recurring items and the elimination of all significant intercompany balances and transactions.

These interim condensed consolidated financial statements should be read in conjunction with the Company's June 30, 2005, Amended Annual Report on Form 10-KSB. Interim results are not necessarily indicative of results for a full year. Certain reclassifications have been made to conform prior period financials to the presentation in the current reporting period. The reclassifications had no effect on net loss.

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

All stock options issued to employees have an exercise price not less than the fair market value of the Company's Common Stock on the date of grant. In accordance with accounting for such options utilizing the intrinsic value method under APB 25, there is no related compensation expense recorded in the Company's financial statements for the nine months ended March 31, 2006 and

2005. 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.

	Nine months ended March 31, 2006	2005
Net loss, as reported	$ (3,662,800)	$ (3,387,200)
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	$ (525,000)	$ (178,100)
Pro forma net loss	$ (4,187,800)	$ (3,565,300)
Net loss per common share, basic and diluted		
As reported	$ (0.13)	$ (0.13)
Pro forma	$ (0.15)	$ (0.14)
Weighted Average Shares Outstanding, Basic and Diluted	28,351,700	25,118,000

During the nine months ended March 31, 2006, the Company granted employee stock options to purchase 2,125,000 shares of the Company's Class A Common Stock at an average purchase price of $0.77, market price on date of grant. The fair value of option grants is estimated as of the date of grant, in accordance with SFAS 123, utilizing the Black-Scholes option-pricing model, with the assumptions substantively utilized in the year-end financial statements.

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

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

In December 2004, the FASB issued Statement No. 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 fiscal year beginning after December 15, 2005 and will effect any stock-based compensation for options issued after that date, or not vested as of that date. In May 2005, the FASB issued Statement No. 154 ("SFAS 154"), "Accounting Changes and Error Corrections." SFAS 154 replaces APB Opinion No. 20, ("APB 20") and SFAS No. 3 to require retrospective application of changes to all prior period financial statements so that those financial statements are presented as if the current accounting principle had always been applied. APB 20 previously required most voluntary changes in accounting principles to be recognized by including in net income of the period of change the cumulative effect of changing to the new accounting principle. In addition, SFAS 154 carries forward without change the guidance contained in APB 20 for reporting a correction of an error in previously issued financial statements and a change in accounting estimate. SFAS 154 is effective for changes and corrections made after January 1, 2006, with early adoption permitted. The Company is currently not contemplating changes that would be impacted by SFAS 154.

Note B - Inventories

Inventories are recorded at the lower of cost or market. The composition of inventories as of March 31, 2006 and June 30, 2005 are summarized as follows:

	March 31, 2006	June 30, 2005
	(unaudited)	
Raw materials and purchased parts	$ 2,378,100	$ 2,011,900
Work-in-progress	112,600	106,000
Finished goods	117,600	99,300
	2,608,300	2,217,200
Less reserves for obsolescence	(355,400)	(314,600)
	$ 2,252,900	$ 1,902,600

Note C - Contracts In Process

Costs incurred, estimated earnings and billings in the RFID Technology segment, related to contracts for the installation of TSI PRISM system in process at March 31, 2006 and June 30, 2005 consist of the following:

	March 31, 2006	June 30, 2005
	(unaudited)	
Costs incurred on uncompleted contracts	$ 71,000	$ 34,100
Estimated gross profit earned to date	13,600	1,700
Revenue earned to date	84,600	35,800
Less Billing to date	(116,500)	(40,000)
Billing in excess of costs and estimated earnings	$ (31,900)	$ (4,200)

Note D - Deferred Revenue

Deferred Revenues at March 31, 2006 and June 30, 2005 consist of the following:

	March 31, 2006	June 30, 2005
	(unaudited)	
Extended warranty revenue	$ 47,400	$ 60,100
Less - current portion	(47,400)	(60,100)
Deferred revenue - long term	$ -	$ -

Note E - Loss Per Share

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

Diluted earnings per share are computed based on the weighted average number of shares of common stock and dilutive securities outstanding during the period. Dilutive securities are options and warrants that are freely exercisable into common stock at less than the prevailing market price. Certain potentially dilutive securities are not included in the weighted average number of shares when inclusion would increase the earnings per share or decrease the loss per share. As of March 31, 2006, when the closing market price of the Company's Class A Common Stock on the NASDAQ Capital Market was $0.65, there were 1,200,000 potentially dilutive in-the-money warrants outstanding and 2,362,500 potentially dilutive in-the-money options outstanding. In addition, as of March 31, 2006, there are 4,307,500 out-of-the-money warrants outstanding and 6,797,500 out-of-the-money options outstanding. There were also 3,122,900 shares of Series A Convertible Preferred Stock outstanding (convertible into 9,368,700 shares of Class A Common Stock) and 73,200 shares of Series B Convertible Preferred Stock outstanding (convertible into 951,600 shares of Class A Common Stock).

Note F - Equity

During the nine months ended March 31, 2006, the Company issued a total of 3,715,000 shares of the Company's Class A Common Stock. Included were

1,990,000 shares issued upon exercise of outstanding warrants and options generating $1,188,600 in proceeds to the Company and 225,000 shares, valued at fair market value on date of issue of $135,100, issued in exchange for future services to be rendered to the Company. In addition, the Company completed the sale on January 17, 2006, of a private offering to an institutional investor, of 1,500,000 units consisting of one share of its Class A Common Stock together with a 3-year warrant to purchase one-half share of the Company's Common Stock at a price of $.85 per share ("Unit") for a unit sale price of $.60. The Company received $830,000, net of commission, from the offering. The Company granted additional warrants to purchase 52,500 shares of its Common Stock on terms identical to those granted in the private offering as additional commission related to the offering.

During March 2005, the Company entered into a technology license agreement with a developer of RFID real-time location services technology utilizing 2.4 GHz wireless networking standards. In conjunction with the execution of the license agreement, the Company issued 250,000 shares of the Company's Class A Common Stock, the value of which may be applied to future royalty payments and inventory purchases ("Prepayment"). Another 150,000 shares were issued under the same terms on December 30, 2005 as consideration to amend the agreement. The value for the 400,000 shares issued is to be determined at market value on the effective date of the applicable stock registration statement; however, due to a delay in the effective date, the Company agreed to fix the value at $.60 per share, before commissions. At March 31, 2006, the shares were valued at $240,000, or $.60 per share, $.05 lower than the closing stock price at March 31, 2006 of $.65 per share. The shares will remain valued at the lower of $.60 per share or the closing price of the Company's common

stock. If the Prepayment value of the 400,000 shares is determined to be less than the $240,000 value ($.60 per share) on the effective date, the Company has an obligation to make additional prepayments so that the total prepayment under the transaction is $240,000, therefore the Company would record an appropriate liability to make up the deficiency. At June 30, 2005, the 250,000 shares previously issued had been valued at $220,700.

On January 19, 2006, the Company filed an S-3 registration statement, which included the 400,000 shares discussed above. That S-3 filing is currently under review by the SEC. The Company is working with the SEC and anticipates an effective date shortly.

In October 2005, the Company reduced the exercise price for warrants (due to expire on December 31, 2005) from $1.00 per share to $.70 per share to purchase 1,450,000 shares of the Company's Class A Common Stock, granted to a group of equity investors in conjunction with a private placement in October 2002. The price was further reduced to $.50 on November 16, 2005 and for every $.50 warrant exercised, a new 3 year warrant was issued at an exercise price of $.50. (In all instances, the adjusted exercise price of the warrants outstanding and the exercise price of the warrants granted represented a value equal to or greater than market on date modified or granted.) Warrants to purchase 600,000 (41.3%) of the 1,450,000 shares were held by officers and directors of the Company, including warrants to purchase 100,000 shares held by Robert R. Kauffman, CEO, Director and greater than five percent (5%) owner of the Company, and warrants to purchase 400,000 shares controlled by Don Anderson, a Director and greater than five percent (5%) owner of the Company. 1,150,000, or 79.3%, of the 1,450,000 warrants modified were exercised by December 31, 2005 (included in the total warrants and options exercised above), resulting in proceeds of $575,000 to the Company.

The Company declared and paid dividends-in-kind during the nine months ended March 31, 2006 on the Company's preferred shares through the issuance of 341,700 shares of Series A Preferred Stock valued at $512,500 and 5,200 shares of Series B Preferred Stock valued at $52,000. The Preferred Stocks are more fully discussed in the Form-10KSB for the year ended June 30, 2005.

Note G -Industry Segment Data

Information concerning operations by industry segment follows (unaudited):

	Nine Months ended 03/31 2006	2005	Three Months en[...] 2006
Revenue			
Data Storage	$ 4,371,400	$ 4,638,200	$ 1,380,900
RFID Technology	321,300	715,700	85,300
Total Revenue	4,692,700	5,353,900	1,466,200
Gross Profit			
Data Storage	1,522,800	1,579,400	531,200
RFID Technology	84,800	281,000	20,300
Total Gross Profit	1,607,600	1,860,400	551,500
Gross Margin			
Data Storage	34.8%	34.1%	38.5%
RFID Technology	26.4%	39.3%	23.8%
Overall Gross Margin	34.3%	34.7%	37.6%
Selling, General and Administrative Expense			
Data Storage	1,530,400	1,351,700	445,300
RFID Technology	2,062,300	2,069,200	692,900
Total Segment Operating Expense	3,592,700	3,420,900	1,138,200
Operating Profit (Loss)			
Data Storage	(7,600)	227,700	85,900
RFID Technology	(1,977,500)	(1,788,200)	(672,600)
Corporate Expense, net	(1,124,100)	(1,358,900)	(441,900)
Operating Loss	$ (3,109,200)	$ (2,919,400)	$ (1,028,600)
Depreciation and Amortization			
Data Storage	18,200	14,500	5,900
RFID Technology	280,500	240,500	75,100
Corporate	2,500	2,300	700

Total Depreciation and Amortization	$ 301,200	$ 257,300	$ 81,700	$

ALANCO TECHNOLOGIES, INC.

Note H - Related Party Transactions

The Company has a $1.5 million line of credit agreement ("Agreement"), more fully discussed in the Company's Form 10-KSB for the year ended June 30, 2005, with a private trust controlled by Mr. Donald Anderson, a greater than five percent stockholder and a member of the Company's Board of Directors. See Note - F Equity for discussion of modification to warrants granted to a group of equity investors, including entities controlled by Mr. Anderson, and including Mr. Robert Kauffman, the Company's CEO and member of the Company's Board of Directors who is also a greater than 5% owner of the Company. Also see Note K - Subsequent Events for discussion of a sale of equity securities to Mr. Anderson subsequent to March 31, 2006.

Note I - Line of Credit

At March 31, 2006, the Company had an outstanding balance under the line of credit agreement of $1,089,000. The balance is under a $1.5 million line of credit agreement with a private trust ("Lender"), entered into in June 2002 and last modified on June 29, 2005. Under the Agreement, the Company must maintain a minimum balance due under the line of at least $1,000,000 through the July 1, 2007 expiration date. As such, the $1,000,000 due under the line of credit agreement is recorded as Notes payable, long term. At March 31, 2006, the Company had $411,000 available under the line of credit agreement.

Note J - Litigation

The Company continues to be a defendant in litigation that relates to the acquisition, in May of 2002, of substantially all the assets of Technology Systems International, Inc., a Nevada corporation. No significant new activity has occurred subsequent to our report of litigation in our Form 10-KSB filed for the year ended June 30, 2005. Due to internal governance issues affecting the plaintiff, the litigation has been indefinitely stayed. The Company's management, in consultation with legal counsel, believes the plaintiff's claims are without merit and the Company will aggressively defend against the action.

Litigation previously reported as arising from an expired property lease between the Company's subsidiary, Arraid, Inc., and Arraid Property L.L.C., a Limited Liability Company, is continuing. The Company's management, in consultation with legal counsel, believes the plaintiff's claims are without merit and the Company is aggressively defending against this action.

Note K - Subsequent Events

The Company completed on April 26, 2006 the sale, in a private offering to a trust beneficially owned by a Director of the Company, of 820,000 units consisting of one share of its Class A Common Stock together with a warrant to purchase one share of the Company's Common Stock at a strike price of $.65 per share ("Unit"). The Company received $500,200 from the offering.

Note L - Nasdaq notification

On February 1, 2006 the Company received notification from Nasdaq granting the Company an extension until July 31, 2006, to comply with Nasdaq's $1.00 per share minimum bid price continued listing requirement.

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 - Industry Segment Data 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 03/31/06 versus 03/31/05

Sales

Consolidated sales for the quarter ended March 31, 2006 were $1,466,200, a decrease of $ 65,000, or 4.2%, when compared to $1,531,200 for the comparable quarter of the prior year. The decrease resulted from a sales decrease in the Data Storage segment of $69,800, or 4.8%, from $1,450,700 for the quarter ended March 31, 2005 to $1,380,900 for the current quarter. The 4.8% decrease in Data Storage segment sales resulted primarily from delayed shipments related to international sales.

Gross Profit and Operating Expenses

Gross profit reported during the quarter amounted to $551,500, a decrease of $4,400, or .8%, when compared to $555,900 reported for the same quarter of the prior year. Consolidated gross margins increased from 36.3% for the quarter ended March 31, 2005 to 37.6% for the current quarter. The increase in gross margin resulted from improved gross margin of the Data Storage segment, which increased to 38.5% from 36.7% for the same quarter of the prior year.

Operating Expenses for the current quarter decreased to $1,580,100, a decrease of $132,100, or 7.7%, when compared to $1,712,200 incurred in the comparable quarter of fiscal year 2005. Sales, general and administrative expenses related to Data Storage decreased to $445,300, a decrease of $27,800, or 5.9%, when compared to sales, general and administrative expense for the same quarter of the prior year. The decrease for the Data Storage segment resulted primarily from a decrease in commission expenses. RFID Technology Segment selling, general and administrative expenses increased from $675,300 for the quarter ended March 31, 2005 to $692,900 in the current quarter, an increase of 2.6%. Corporate expense decreased to $441,900, a decrease of $121,900, or 21.6%, from the $563,800 reported in the quarter ended March 31, 2005, due to reductions in legal expenses.

Operating Loss

The Operating Loss for the quarter was ($1,028,600) compared to a loss of ($1,156,300) for the same quarter of the prior year, a decrease of $127,700, or 11%. The decrease in Operating Loss resulted from the Data Storage segment reporting an Operating Profit of $85,900, compared to an Operating profit of $59,300 reported in the comparable quarter of the prior year and a decrease in corporate expenses. The RFID Technology segment increased its Operating Loss by ($20,800) to ($672,600), an increase of 3.2%, when compared to the Operating Loss reported in the same quarter of the prior year of ($651,800). The Data Storage segment's increase in operating profit was due primarily to the increase in gross margin and decreases in operating expenses.

Interest Expense, Other Income and Dividends Expense

Net interest expense for the quarter amounted to $23,700 compared to interest expense of $11,200 for the same quarter in the prior year. The interest expense increase resulted from increases in the prime rate, and an increase in the minimum borrowing limit of our credit line. Other Income decreased slightly to $60,200 from $63,900 reported for the comparable quarter of the prior year. The Company paid quarterly in-kind Series B Preferred Stock dividends with values of $281,500 and $252,000 in the quarters ended March 31, 2006 and 2005, respectively.

Net Loss Attributable to Common Stockholders

Net Loss Attributable to Common Stockholders for the quarter ended March 31, 2006 amounted to ($1,273,600), or ($.04) per share, compared to a loss of ($1,355,600), or ($.05) per share, in the comparable quarter of the prior year. Although the Company has reported a significant Net Loss Attributable to Common Stockholders for both the current quarter and the same quarter of the prior year, it anticipates continued improving future operating results. However, actual results in both the Data Storage segment and the RFID Technology segments may be affected by unfavorable economic conditions and reduced capital spending budgets. If the economic conditions in the United States worsen or if a wider or global economic slowdown occurs, Alanco may experience a material adverse impact on its operating results and business conditions.

(B) Nine months ended 03/31/2006 versus 03/31/2005

Sales

Consolidated Sales for the nine months ended March 31, 2006 were $4,692,700, a decrease of $661,200, or 12.3%, compared to $5,353,900 reported for the comparable period of the previous year. The sales decrease is attributed to decreases in both of the Company's two business segments. The Company's Data Storage segment reported sales of $4,371,400, a decrease of $266,800, or 5.8%, for the nine months ended March 31, 2006, compared to $4,638,200 reported for the nine months ended March 31, 2005. The RFID Technology segment reported sales of $321,300, a 55.1% decrease when compared to $715,700 reported for the comparable period in the prior fiscal year.

Gross Profit and Operating Expenses

Gross profit generated during the nine month period ended March 31, 2006 amounted to $1,607,600, a decrease of $252,800, or 13.6%, when compared to $1,860,400 reported for the same period of the prior year. Gross margins decreased slightly from 34.7% for the nine months ended March 31, 2005 to 34.3% for the current period. The decrease in gross margin resulted from a reduced gross margin in the RFID Technology segment due to low sales volumes. The gross margin in the Data Storage segment increased from 34.1% to 34.8% when comparing the current quarter to the comparable quarter of the previous year.

Operating expenses for the nine months ended March 31, 2006 decreased to $4,716,800, a 1.3% or $63,000 decrease, when compared to $4,779,800 incurred in the comparable period of fiscal year 2005. The decrease was due primarily to a decrease in corporate legal expense.

Operating Loss

The Operating Loss for the nine-month period was ($3,109,200) compared to a loss of ($2,919,400) for the same nine-month period of the prior fiscal year, an increase of $189,800 or 6.5%. The increased Operating Loss resulted from the RFID Technology segment increasing its loss by $189,300, or 10.6%, to ($1,977,500), compared to a loss of ($1,788,200) in the prior year, and the Data Storage Segment reporting a loss of ($7,600) compared to a $227,700 operating profit in the prior year. Corporate expense decreased by $234,800.

Interest Expense, Other Income and Dividends Expense

Net interest expense for the nine months ended March 31, 2006 amounted to $65,900 compared to net interest expense of $38,800 for the same nine-month period in the prior year. The increase resulted from increases in the prime rate, and an increase in the minimum borrowing limit of our credit line. Other income increased slightly from $74,700 for the nine month period ended march 31, 2005 to $76,900 for the current period. The Company paid in-kind Series A and Series B Preferred Stock dividends with values of $564,600 and $503,700 in the nine months ended March 31, 2006 and 2005, respectively.

Net Loss Attributable to Common Stockholders

Net Loss Attributable to Common Stockholders for the nine months ended March 31, 2006 amounted to ($3,662,800), or ($.13) per share, compared to a loss of ($3,387,200), or ($.13) per share, in the comparable period of the prior year. Although the Company has reported increased operating losses in both the RFID Technology segment and its Data Storage segment, it anticipates improved future operating results in both segments as markets improve. However, actual results in both the Data Storage segment and the RFID Technology segments may be affected by unfavorable economic conditions and reduced capital spending budgets. If the economic conditions in the United States worsen or if a 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 March 31, 2006 exceeded current liabilities by $2,287,900, resulting in a current ratio of 2.4 to 1. At June 30, 2005 the Company's current assets exceeded current liabilities by $2,845,600, reflecting a current ratio of 3.12 to 1. The decrease in the current ratio at March 31, 2006 when compared to June 30, 2005 resulted primarily from funding

operating losses during the period. Accounts receivable of $925,400 at March 31, 2006, reflects a decrease of $166,000, or 15.2%, when compared to the $1,091,400 reported as consolidated accounts receivable at June 30, 2005. The accounts receivable balance at March 31, 2006 represented fifty four days' sales in receivables compared to the same fifty four days' sales at June 30, 2005. The Data Storage segment reported 38 days' sales in receivables while the RFID Technology segment reported 259 days sales in receivables. The high RFID Technology segment days sales were due to a contract holdback and slow payments. Payment of all material balances in the RFID accounts receivable had either been received by filing date of this Form 10-QSB or payment is anticipated to be received in the next 30 days.

Consolidated inventories at March 31, 2006 amounted to $2,252,900, an increase of $350,300, or 18.4%, when compared to $1,902,600 at June 30, 2005. March 31, 2006 balances reflect an inventory turnover of 1.8 compared to an inventory turnover of 2.5 reported at June 30, 2005. The continued high inventory levels reflect management's continued anticipated revenue increases for the RFID Technology segment and continuing current sales levels for the Data Storage Segment.

At March 31, 2006, the Company had an outstanding balance of $1,089,000 under a $1.5 million formula-based revolving bank line of credit agreement with interest calculated at prime plus 2%. The line of credit formula is based upon current asset values and is used to finance working capital. At March 31, 2006, the Company had $411,000 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 nine-month period ended March 31, 2006 was $2,842,000 an increase of $152,700 when compared to cash used in operations of $2,689,300 for the comparable period ended March 31, 2005. The increase resulted primarily from increases in operating losses and inventory levels during the current period.

During the nine months ended March 31, 2006, the Company reported cash flows from investing activities of $53,000, compared to $31,900 reported for the nine months ended March 31, 2005. The increase is primarily the result of reduced purchases of property, plant and equipment and a reduction in assets held for sale.

Cash provided by financing activities for the nine months ended March 31, 2006 amounted to $2,249,000, an increase of $954,200, or 73.7%, compared to the $1,294,800 provided by financing activities for the nine months ended March 31, 2005. The increase resulted from increases in net proceeds by financing activities of $689,500 and increases in net borrowing when compared to the prior year.

Cash and cash equivalents at March 31, 2006 amounted to $197,300. In addition, the Company had $411,000 available under its line of credit agreement (see Note I - Line of Credit) and subsequent to March 31, 2006, the Company completed the sale of 820,000 units consisting of one share of its Class A Common Stock together with a warrant to purchase one share of the Company's Common Stock at a price of $.85 per share ("Unit"). The Company received $500,200 from the offering (See Note K - Subsequent Events).

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

Item 3 - CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures designed to ensure that it is able to collect the information it is required to disclose in the reports it files with the Securities and Exchange Commission (SEC), and to process, summarize and disclose this information within the time periods specified in the rules of the SEC. Based on various evaluations of the Company's disclosure controls and procedures, as of the end of the period covered by this Form 10-QSB, 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.

During the fiscal quarter covered by this report we made no change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) under the Exchange Act) which materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The Company continues to be a defendant in litigation that relates to the acquisition, in May of 2002, of substantially all the assets of Technology Systems International, Inc., a Nevada corporation. No significant new activity has occurred subsequent to our report of litigation in our Form 10-KSB filed for the year ended June 30, 2005. Due to internal governance issues affecting the plaintiff, the litigation has been indefinitely stayed. The Company's 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, is continuing. The Company's management, in consultation with legal counsel, believes the plaintiff's claims are without merit and the Company is aggressively defending against this action. The Company intends to pursue legal expense reimbursement from both the Company's insurance carrier (where appropriate) and the Plaintiffs in the litigation matters.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the nine months ended March 31, 2006, the Company issued 341,700 shares of Series A Preferred Stock and 3,400 shares of Series B Preferred Stock as dividend in-kind payments, 1,990,000 shares of Class A Common Stock for the exercise of existing warrants and options, 1,500,000 shares of Class A Common Stock in a private offering to an accredited investor, and 225,000 shares of Common Stock for services rendered.

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ALANCO TECHNOLOGIES, INC.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

Item 6. EXHIBITS

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

SIGNATURE

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

ALANCO TECHNOLOGIES, INC.
(Registrant)

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

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ALANCO TECHNOLOGIES, INC.

EXHIBIT 31.1

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

I, Robert R. Kauffman, certify that:

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

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

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

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

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

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

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

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

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

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

Date: May 15, 2006

/s/ Robert R. Kauffman

Robert R. Kauffman
Chairman and Chief Executive Officer

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ALANCO TECHNOLOGIES, INC.

EXHIBIT 31.2

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

I, John A. Carlson, certify that:

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

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

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

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

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

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

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

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

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

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

Date: May 15, 2006
/s/ John A. Carlson

John A. Carlson
Executive Vice President and Chief Financial Officer

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ALANCO TECHNOLOGIES, INC.

EXHIBIT 32.1

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

This certification is provided pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and accompanies this quarterly report of Form 10-QSB (the "Report") for the period ended March 31, 2006 of Alanco Technologies, Inc. (the "Issuer").

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

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

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

Dated: May 15, 2006

/s/ Robert R. Kauffman

Robert R. Kauffman
Chief Executive Officer

/s/ John A. Carlson

John A. Carlson
Chief Financial Officer