

ALANCO TECHNOLOGIES INC  
Form 10-Q  
February 18, 2011

ALANCO TECHNOLOGIES, INC.

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the quarterly period ended December 31, 2010

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 registrant 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  
(Registrant's telephone number)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer   
Non-accelerated file  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes       No

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

As of February 9, 2011 there were 5,534,400 shares, net of treasury shares, of common stock outstanding.

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ALANCO TECHNOLOGIES, INC.

Forward-Looking Statements: 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. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words “believe,” “may,” “estimate,” “continue,” “anticipate,” “intend,” “should,” “plan,” “could,” “target,” “potentially,” “will,” “expect” and similar expressions, as they relate to the Company are intended to identify forward-looking statements within the meaning of the “safe harbor” provisions of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. From time to time, the Company may publish or otherwise make available forward-looking statements of this nature. All such forward-looking statements are based on the expectations of management when made and are subject to, and are qualified by, 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, among others, that could affect the outcome of the Company's forward-looking statements: 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; unfavorable result of current pending 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; the ability to maintain satisfactory relationships with suppliers; federal and/or state regulatory and legislative actions; customer preferences and spending patterns; the ability to implement or adjust to new technologies and the ability to secure and maintain key contracts and relationships. New risk factors emerge from time to time and it is not possible to accurately predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any risk factor, or combination of risk factors, may cause results to differ materially from those contained in any forward-looking statements. Except as otherwise required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statements or the risk factors described in this Quarterly Report or in the documents we incorporate by reference, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Quarterly Report on Form 10-Q.

## ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2010 AND JUNE 30, 2010

|  | December 31, 2010<br>(unaudited) | June 30, 2010        |
|--|----------------------------------|----------------------|
| <b>ASSETS</b>                                  |                                  |                      |
| <b>CURRENT ASSETS</b>                          |                                  |                      |
| Cash and cash equivalents                      | \$ 537,600                       | \$ 400,500           |
| Accounts receivable, net                       | 1,984,200                        | 2,493,900            |
| Inventories, net                               | 1,848,900                        | 1,222,500            |
| Assets related to discontinued operations      | 39,500                           | 1,971,000            |
| Prepaid expenses and other current assets      | 491,600                          | 654,700              |
| Total current assets                           | 4,901,800                        | 6,742,600            |
| <b>PROPERTY, PLANT AND EQUIPMENT, NET</b>      | 327,600                          | 233,800              |
| <b>OTHER ASSETS</b>                            |                                  |                      |
| Goodwill                                       | 12,575,400                       | 12,575,400           |
| Other intangible assets, net                   | 554,700                          | 770,200              |
| Other assets                                   | 32,100                           | 174,200              |
| Total other assets                             | 13,162,200                       | 13,519,800           |
| <b>TOTAL ASSETS</b>                            | <b>\$ 18,391,600</b>             | <b>\$ 20,496,200</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>    |                                  |                      |
| <b>CURRENT LIABILITIES</b>                     |                                  |                      |
| Accounts payable and accrued expenses          | \$ 2,387,700                     | \$ 1,917,100         |
| Dividends payable                              | 51,500                           | 56,400               |
| Notes payable, current                         | 4,428,000                        | 6,328,000            |
| Capital leases                                 | 14,500                           | 18,100               |
| Customer advances                              | 176,900                          | 4,500                |
| Liabilities related to discontinued operations | 1,433,100                        | 1,498,100            |
| Deferred revenue                               | 325,000                          | 309,300              |
| Total current liabilities                      | 8,816,700                        | 10,131,500           |
| <b>LONG-TERM LIABILITIES</b>                   |                                  |                      |
| Deferred revenue, long-term                    | 329,800                          | 375,500              |
| Capital leases, long-term                      | -                                | 5,000                |
| <b>TOTAL LIABILITIES</b>                       | <b>9,146,500</b>                 | <b>10,512,000</b>    |

|  |           |           |
|--|-----------|-----------|
| Preferred Stock - Series B Convertible - 500,000 shares authorized, 116,800 and 111,200 issued and outstanding, respectively | 1,154,500 | 1,098,500 |
|--|-----------|-----------|

SHAREHOLDERS' EQUITY

|   |             |             |
|---|-------------|-------------|
| Preferred Stock   |             |             |
| Preferred Stock - Series D Convertible - 500,000 shares authorized, 82,300 and 134,200 shares issued and outstanding, respectively  | 814,900     | 1,333,800   |
| Preferred Stock - Series E Convertible - 750,000 shares authorized, 725,000 and 735,000 shares issued and outstanding, respectively   | 3,165,900   | 3,210,900   |
| Common Stock  |             |             |
| Class A - 75,000,000 shares authorized, 5,507,600 and 4,665,500 shares, net of 200 treasury shares valued at \$2,800 and 2,000 valued at \$30,000, outstanding at December 31, 2010 and June 30, 2010, respectively | 109,336,200 | 107,355,700 |
| Class B - 25,000,000 shares   | -           | -           |

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|   |                      |           |                   |
|---|----------------------|-----------|-------------------|
| authorized and 0<br>shares outstanding                      |                      |           |                   |
| Accumulated deficit   | (105,226,400)        |           | (103,014,700)     |
| Total shareholders'<br>equity                               | 8,090,600            |           | 8,885,700         |
| <b>TOTAL LIABILITIES &amp;<br/>SHAREHOLDERS'<br/>EQUITY</b> | <b>\$ 18,391,600</b> | <b>\$</b> | <b>20,496,200</b> |

See accompanying notes to the condensed consolidated financial statements



## ALANCO TECHNOLOGIES, INC.

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

|  | 2010         | 2009          |
|--|--------------|---------------|
| NET SALES  | \$ 3,958,200 | \$ 3,627,200  |
| Cost of goods sold                                       | 2,475,300    | 2,297,100     |
| GROSS PROFIT   | 1,482,900    | 1,330,100     |
| Selling, general and administrative expense              | 1,587,500    | 1,235,900     |
| Corporate expense  | 282,900      | 269,700       |
| Amortization of stock-based compensation                 | 59,800       | 70,200        |
| Depreciation and amortization                            | 126,300      | 134,500       |
| OPERATING LOSS   | (573,600)    | (380,200)     |
| OTHER INCOME & (EXPENSES)                                |              |               |
| Interest expense, net                                    | (86,300)     | (205,400)     |
| Other income (expense), net                              | (9,000)      | (1,100)       |
| LOSS FROM CONTINUING OPERATIONS                          | (668,900)    | (586,700)     |
| LOSS FROM DISCONTINUED OPERATIONS                        | (100,000)    | (603,600)     |
| NET LOSS   | (768,900)    | (1,190,300)   |
| Preferred stock dividends                                | (79,800)     | (117,700)     |
| NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS             | \$(848,700)  | \$(1,308,000) |
| NET LOSS PER COMMON SHARE - BASIC AND DILUTED            |              |               |
| - Continuing operations                                  | \$(0.12)     | \$(0.14)      |
| - Discontinued operations                                | \$(0.02)     | \$(0.14)      |
| - Preferred stock dividends                              | \$ (0.02)    | \$(0.03)      |
| - Net loss per share attributable to common shareholders | \$(0.16)     | \$(0.31)      |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING               |              |               |
| - Basic and diluted                                      | 5,437,400    | 4,241,400     |

See accompanying notes to the condensed consolidated financial statements



## ALANCO TECHNOLOGIES, INC.

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

|  | 2010          | 2009          |
|--|---------------|---------------|
| NET SALES  | \$ 7,652,800  | \$ 6,604,100  |
| Cost of goods sold                                       | 4,966,500     | 4,001,500     |
| GROSS PROFIT   | 2,686,300     | 2,602,600     |
| Selling, general and administrative expense              | 3,135,000     | 2,430,500     |
| Corporate expense  | 585,800       | 430,500       |
| Amortization of stock-based compensation                 | 397,700       | 239,000       |
| Depreciation and amortization                            | 256,500       | 270,100       |
| OPERATING LOSS   | (1,688,700)   | (767,500)     |
| OTHER INCOME & (EXPENSES)                                |               |               |
| Interest expense, net                                    | (254,100)     | (379,900)     |
| Other income (expense), net                              | (9,300)       | (1,900)       |
| LOSS FROM CONTINUING OPERATIONS                          | (1,952,100)   | (1,149,300)   |
| LOSS FROM DISCONTINUED OPERATIONS                        | (100,000)     | (1,106,400)   |
| NET LOSS   | (2,052,100)   | (2,255,700)   |
| Preferred stock dividends                                | (159,600)     | (258,200)     |
| NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS             | \$(2,211,700) | \$(2,513,900) |
| NET LOSS PER COMMON SHARE - BASIC AND DILUTED            |               |               |
| - Continuing operations                                  | \$(0.37)      | \$(0.28)      |
| - Discontinued operations                                | \$(0.02)      | \$(0.26)      |
| - Preferred stock dividends                              | \$(0.03)      | \$(0.06)      |
| - Net loss per share attributable to common shareholders | \$(0.42)      | \$(0.60)      |
| WEIGHTED AVERAGE COMMON SHARES OUTSTANDING               |               |               |
| - Basic and diluted                                      | 5,265,800     | 4,158,100     |

See accompanying notes to the condensed consolidated financial  
statements

## ALANCO TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE SIX MONTHS ENDED DECEMBER 31, 2010 (unaudited)

|  | COMMON STOCK<br>(NET OF TREASURY STOCK) |                | SERIES D<br>PREFERRED STOCK |              | SERIES E<br>PREFERRED STOCK |              | ACCUMULATED<br>DEFICIT |
|--|---|----------------|-----------------------------|--------------|-----------------------------|--------------|------------------------|
|  | SHARES                                  | AMOUNT         | SHARES                      | AMOUNT       | SHARES                      | AMOUNT       |                        |
| Balances, June 30, 2010                                | 4,665,500                               | \$ 107,355,700 | 134,200                     | \$ 1,333,800 | 735,000                     | \$ 3,210,900 | (103,014)              |
| Shares issued for services                             | 3,100                                   | 5,300          | -                           | -            | -                           | -            |                        |
| Shares issued for payment of notes                     | 1,100                                   | 2,100          | -                           | -            | -                           | -            |                        |
| Shares issued for exercise of warrants                 | 256,200                                 | 304,800        | -                           | -            | -                           | -            |                        |
| Value of stock based compensation                      | -                                       | 400,700        | -                           | -            | -                           | -            |                        |
| Private offering, net of expenses                      | 384,300                                 | 612,400        | -                           | -            | -                           | -            |                        |
| Series B Preferred dividends, paid in kind             | -                                       | -              | -                           | -            | -                           | -            | (50,000)               |
| Series D Preferred dividends, paid or accrued          | 16,600                                  | 27,100         | -                           | -            | -                           | -            | (20,000)               |
| Conversion of Series D preferred stock to common stock | 129,700                                 | 518,900        | (51,900)                    | (518,900)    | -                           | -            |                        |
| Series E Preferred dividends, paid or accrued          | 34,300                                  | 54,900         | -                           | -            | -                           | -            | (82,000)               |
| Conversion of Series E preferred                       |   |                |                             |              |                             |              |                        |

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|                                   |           |                |        |            |          |              |    |           |
|-----------------------------------|-----------|----------------|--------|------------|----------|--------------|----|-----------|
| stock to<br>common<br>stock       | 15,000    | 45,000         | -      | -          | (10,000) | (45,000)     |    |           |
| NASDAQ<br>listing fees            | -         | (17,900)       | -      | -          | -        | -            |    |           |
| Treasury<br>share<br>adjustment   | 1,800     | 27,200         |        |            |          |              |    |           |
| Net loss                          | -         | -              | -      | -          | -        | -            |    | (2,052)   |
| Balances,<br>December 31,<br>2010 | 5,507,600 | \$ 109,336,200 | 82,300 | \$ 814,900 | 725,000  | \$ 3,165,900 | \$ | (105,226) |

See accompanying notes to the condensed consolidated financial statements

## ALANCO TECHNOLOGIES, INC.

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

|   | 2010           | 2009           |
|---|----------------|----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                 |                |                |
| Net loss  | \$ (2,052,100) | \$ (2,255,700) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                |                |
| Depreciation and amortization   | 259,900        | 324,000        |
| Stock-based compensation  | 400,700        | 259,400        |
| Stock issued for services   | 5,300          | 19,000         |
| Impairment charge   | -              | 325,000        |
| Interest converted to equity  | -              | 50,000         |
| Fees and interest paid with debt  | -              | 96,200         |
| Changes in operating assets and liabilities:                                |                |                |
| Accounts receivable, net  | 502,200        | 2,500          |
| Inventories, net  | (556,000)      | 474,300        |
| Costs and estimated earnings in excess of billings                          |                |                |
| on uncompleted contracts  | 12,700         | 55,000         |
| Prepaid expenses and other current assets                                   | 113,000        | 119,900        |
| Accounts payable and accrued expenses                                       | 297,300        | (1,421,800)    |
| Deferred revenue  | (46,400)       | 91,600         |
| Billings in excess of costs and estimated earnings                          |                |                |
| on uncompleted contracts  | 7,300          | (139,700)      |
| Customer advances   | 172,400        | 777,400        |
| Other assets  | 32,200         | 63,000         |
| Net cash used in operations   | (851,500)      | (1,159,900)    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                 |                |                |
| Purchase of property, plant and equipment                                   | (4,900)        | (10,900)       |
| Proceeds from sale of net RFID Technology segment assets                    | 2,000,000      | -              |
| Net cash provided by (used in) investing activities                         | \$ 1,995,100   | \$ (10,900)    |

See accompanying notes to the condensed consolidated financial statements



## ALANCO TECHNOLOGIES, INC.

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

|   | 2010        | 2009       |
|---|-------------|------------|
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                   |             |            |
| Proceeds from borrowings                                      | \$ 484,900  | \$ 362,700 |
| Repayment on borrowings                                       | (2,382,800) | (51,200)   |
| Repayment of capital lease                                    | (8,600)     | (7,200)    |
| Proceeds from sale of equity instruments, net                 | 944,400     | 848,300    |
| Cash dividends paid   | (26,500)    | (5,400)    |
| Other   | (17,900)    | (19,400)   |
| Net cash provided by (used in) financing activities           | (1,006,500) | 1,127,800  |
| <br>  |             |            |
| NET INCREASE (DECREASE) IN CASH                               | 137,100     | (43,000)   |
| <br>  |             |            |
| CASH AND CASH EQUIVALENTS, beginning of period                | 400,500     | 726,900    |
| <br>  |             |            |
| CASH AND CASH EQUIVALENTS, end of period                      | \$ 537,600  | \$ 683,900 |
| <br><b>SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION</b>     |             |            |
| <br>  |             |            |
| Net cash paid during the period for interest                  | \$ 254,100  | \$ 171,500 |
| <br>  |             |            |
| Non-Cash Activities:  |             |            |
| Value of shares issued for services and credit line amendment | \$ 5,300    | \$ 19,000  |
| Value of stock issued for payment of notes                    | \$ 2,100    | \$ 460,000 |
| Series B preferred stock dividend, paid in kind               | \$ 56,000   | \$ 50,700  |
| Series D preferred stock dividend, paid in kind               | \$ -        | \$ 166,700 |
| Series D preferred stock dividend, paid in common stock or    | \$ 33,400   | \$ 67,000  |

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|                         |    |         |    |           |
|-------------------------|----|---------|----|-----------|
| accrued                 |    |         |    |           |
| Series D preferred      | \$ | -       | \$ | 1,691,100 |
| stock converted to line |    |         |    |           |
| of credit               |    |         |    |           |
| Series D preferred      | \$ | 518,900 | \$ | -         |
| stock converted to      |    |         |    |           |
| common stock            |    |         |    |           |
| Series E preferred      | \$ | 53,500  | \$ | -         |
| stock dividend, paid in |    |         |    |           |
| common stock or         |    |         |    |           |
| accrued                 |    |         |    |           |
| Series E preferred      | \$ | 45,000  | \$ | -         |
| stock converted to      |    |         |    |           |
| common stock            |    |         |    |           |

See accompanying notes to the condensed consolidated financial statements

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note A – Basis of Presentation and Recent Accounting Pronouncements

Alanco Technologies, Inc., an Arizona corporation (“Alanco” or “Company”), has in recent years reported three business segments: Data Storage, Wireless Asset Management and RFID Technology. At June 30, 2010, in compliance with the Company’s divestiture plan to divest the Data Storage and RFID Technology segments and invest the proceeds into the Wireless Asset Management segment, the Data Storage and RFID Technology segments had either been sold or were presented as “Assets Held for Sale” and “Liabilities Related to Assets Held for Sale”. The Wireless Asset Management segment was the only business segment classified as a continuing operation at December 31, 2010.

As previously reported, the Company has solicited investment banker advice to evaluate strategic alternatives available to enhance shareholder value and is continuing its evaluation of those alternatives. Although the Company is committed to maximizing shareholder value and will continue to evaluate its strategic initiatives, there can be no assurance of any particular outcome or course of action.

The Company announced on August 26, 2010 that the Board of Directors had elected to effect a 1 for 8 reverse stock split that was effective on August 27, 2010, when the Company’s common stock began trading on a post split-adjusted basis under the interim trading symbol “ALAND” for a period of 20 days, after which the Company’s trading symbol returned to “ALAN”. (The Company again began trading under the symbol “ALAN” on September 27, 2010.) The Company had previously received authority from its shareholder to effect a reverse split at a ratio within a specified range, if and as determined by the Board of Directors, in order to maintain NASDAQ listing.

As a result of the reverse split, each eight (8) shares of the Company’s Class A Common Stock outstanding at the time of the reverse split was automatically reclassified and changed into one share of common stock, and the total number of common shares outstanding was reduced from approximately 41.7 million shares to approximately 5.2 million shares post split. The reverse stock split resulted in the same adjustment to the Company’s outstanding stock options and securities reserved for issuance under its current incentive plans. No fractional shares were issued in connection with the reverse stock split. Upon surrender of their stock certificates, shareholders have received or will receive, cash in lieu of the fractional shares to which they would otherwise be entitled. All per share amounts and outstanding shares, including all common stock equivalents (stock options, warrants and convertible securities) have been restated in the Condensed Consolidated Financial Statements, the Notes to the Consolidated Financial Statements and the loss per share for all periods presented to reflect the reverse stock split.

The unaudited condensed consolidated financial statements 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-Q. 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, 2010 Annual Report filed on Form 10-K. Interim results are not necessarily indicative of results for a full year. Certain reclassifications may 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.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

The Company received a letter of reprimand from Nasdaq on December 28, 2010 concerning Nasdaq's belief that the Company has failed to maintain a majority of independent directors on its Board of Directors in violation of Nasdaq rule 5605 (b)(1), and had a non-independent director on its Nominating Committee in violation of Nasdaq Rule 5605 (e)(1). In particular, Nasdaq has determined that Donald E. Anderson, who served as a director from June 2002 until his resignation on October 4, 2010 and was a member of the Company's Nominating Committee, should not have been classified as an independent director under Nasdaq Rule 5605(a)(2)(d). The Company relied upon outside counsel who determined that the instrument representing the Company's obligation to repay a long term loan by a Trust involving Mr. Anderson constituted a security and that the exception provided by Nasdaq Rule 5605(a)(2)(D)(i) applied. Although there is no Nasdaq Rule or published interpretation to the contrary, Nasdaq staff determined that said obligation of the Company does not constitute a security for purposes of the exemption and Mr. Anderson was therefore not independent.

Nasdaq also found that the Company's violation does not appear to have been the result of a deliberate intent to avoid compliance and was based upon advice of outside counsel. Therefore, the appropriate sanction is issuance of the Letter of Reprimand. The Company has until its next Annual Meeting of Shareholders anticipated to occur in April 2011 to regain compliance with Nasdaq Rule 5605(b)(1).

The Company has stock-based compensation plans and reports stock-based compensation expense for all stock-based compensation awards based on the estimated grant date fair value. The value of the compensation cost is amortized at a minimum on a straight-line basis over the requisite service periods of the award (generally the option vesting term).

The Company estimates fair value using the Black-Scholes valuation model. Assumptions used to estimate compensation expense are determined as follows:

- Expected term is determined under the simplified method using an average of the contractual term and vesting period of the award as appropriate statistical data required to properly estimate the expected term was not available;
- Expected volatility of award grants made under the Company's plans is measured using the historical daily changes in the market price of the Company's common stock over the expected term of the award;
- Risk-free interest rate is to approximate the implied yield on zero-coupon U.S. Treasury bonds with a remaining maturity equal to the expected term of the awards; and,
- Forfeitures are based on the history of cancellations of awards granted by the Company and management's analysis of potential future forfeitures.

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.

Fair value of financial instruments – The estimated fair values for financial instruments are determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The carrying amounts of accounts receivable, accounts payable, accrued liabilities, and notes payable approximate fair value given their short-term nature or with regards to long-term notes payable based on borrowing rates currently available to the Company for loans with similar terms and maturities.



## ALANCO TECHNOLOGIES, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

## Recent Accounting Pronouncements

With the exception of those discussed below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the six months ended December 31, 2010, that are of significance, or potential significance, to us.

In October 2008, the EITF issued guidance which addresses the accounting when entities enter into revenue arrangements with multiple payment streams for a single deliverable or a single unit of accounting. The Company has adopted the guidance which does not have an impact on its financial position and results of operations at this time.

In December 2010, the FASB issued guidance which addresses the pro forma disclosure requirements for business combinations. The guidance is effective for acquisition dates on or after the beginning of the first annual reporting period after December 15, 2010. The Company has adopted the guidance which does not have an impact on its financial position and results of operations at this time.

## Note B – Stock-Based Compensation and Warrants

The Company has several employee stock option and officer and director stock option plans that have been approved by the shareholders of the Company. The plans require that options be granted at a price not less than market on date of grant and are more fully discussed in our Form 10-K for the year ended June 30, 2010.

The Company uses the Black-Scholes option pricing model to estimate fair value of stock-based awards.

Assumptions for awards of options granted during the six months ended December 31, 2010 were:

|  | Awards granted<br>six months ended<br>December 31,<br>2010 |
|--|--|
| Dividend yield                         | 0%   |
| Expected volatility                    | 62%  |
| Weighted-average volatility            | 62%  |
| Risk-free interest rate                | 2% -   |
|  | 4%   |
| Expected life of options (in years)    | 2.0 - 3.75   |
| Weighted average grant-date fair value | \$.67  |

The following table summarizes the Company's stock option activity during the first six months of fiscal 2011:

## ALANCO TECHNOLOGIES, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

|                               | Shares    | Weighted<br>Average<br>Exercise<br>Price<br>Per Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (1) | Aggregate<br>Fair<br>Value | Aggregate<br>Intrinsic<br>Value (2) |
|-------------------------------|-----------|---|---|----------------------------|-------------------------------------|
| Outstanding July 1, 2010      | 955,800   | \$6.27  | 3.01  | \$ 4,324,300               | -                                   |
| Shares repriced during period | (866,000) | \$5.82  | 2.78  | (3,873,400)                | -                                   |
| Repriced replacement shares   | 866,000   | \$1.52  | 2.78  | 415,900                    | -                                   |
| Granted                       | 110,000   | \$2.14  | 4.60  | 73,800                     | -                                   |
| Exercised                     | -         | \$0.00  | -   | -                          | -                                   |
| Forfeited or expired          | (64,800)  | \$6.07  | -   | (293,200)                  | -                                   |
| Outstanding December 31, 2010 | 1,001,000 | \$1.98  | 2.76  | \$ 647,400                 | \$0                                 |
| Exercisable December 31, 2010 | 746,600   | \$2.09  | 2.30  | \$ -                       | \$0                                 |

(1) Remaining contractual term presented in years.

(2) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing price of the Company's common stock as of December 31, 2010, for those awards that have an exercise price below the closing price as of December 31, 2010 of \$1.40.

As of December 31, 2010, the Company had 201,100 warrants outstanding with a weighted average exercise price of \$5.77. The life of the outstanding warrants extends from September 30, 2011 through July 9, 2013. The following table summarizes the Company's warrant activity during the first six months of fiscal 2011:

|                                     | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price \$ |
|-------------------------------------|---------------------|---|
| Warrants Outstanding, June 30, 2010 | 409,000             | \$ 11.47                                    |



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|  |           |         |
|--|-----------|---------|
| Granted  | 95,100    | 2.64    |
| Exercised  | (256,200) | 1.19    |
| Canceled/Expired                                       | (46,800)  | 24.00   |
| Warrants Outstanding, December 31,<br>2010 (unaudited) | 201,100   | \$ 5.77 |

Note C – Inventories

Inventories are recorded at the lower of cost or market. During the quarter ended December 31, 2010, the Company wrote off obsolete inventory against the recorded reserve. The composition of inventories as of December 31, 2010 and June 30, 2010 are summarized as follows:

## ALANCO TECHNOLOGIES, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

|                                   | December<br>31,<br>2010<br>(unaudited) | June 30,<br>2010 |
|-----------------------------------|--|------------------|
| Raw materials and purchased parts | \$ 1,848,900                           | \$1,637,500      |
| Finished goods                    | -                                      | -                |
|                                   | 1,848,900                              | 1,637,500        |
| Less reserves for obsolescence    | -                                      | (415,000)        |
|                                   | \$ 1,848,900                           | \$1,222,500      |

## Note D – Discontinued Operations

During fiscal 2009, the Company implemented a plan to divest the operations of its Data Storage segment and reinvest the proceeds into the remaining business segments. The Company expanded its divestiture plan during the quarter ended September 30, 2009 to include the RFID Technology segment. During the quarter ended March 31, 2010, the Company executed an agreement to sell substantially all of the assets and liabilities of its Data Storage segment. Accordingly, the “Assets Held for Sale” and “Liabilities Related to Assets Held for Sale” presented in the June 30, 2010 balance sheet consist primarily of the RFID Technology segment. The reclassification of those segment assets and liabilities to “Assets Held for Sale” and “Liabilities Related to Assets Held for Sale” does not affect the reported net loss for the periods presented.

On August 18, 2010, the Company announced the divestiture of Alanco/TSI PRISM, Inc. (“TSI”) operations, the Company’s RFID Technology segment, with the sale of substantially all of the assets and business of TSI to Black Creek Integrated Systems Corp., a private company located in Irondale, Alabama. The transaction, which closed August 17, 2010, consisted of approximately \$2 million in cash, and a potential earn-out that could approach five hundred thousand to one million dollars. (The earn-out has not been valued in the transaction due to the lack of supportability.) With the previously announced sale of the Company’s Data Storage segment, the transaction marks the substantial completion of the Company’s asset divestiture program and redeployment of resources to focus upon the future of the Company and growth of the Company’s StarTrak wireless asset management business. At December 31, 2010, the “Assets Related to Discontinued Operations” and “Liabilities Related to Discontinued Operations” represent assets retained by seller or receivables resulting from the sales transaction, and liabilities not assumed in the transactions. The divestiture program significantly improved Alanco’s financial position by reducing secured debt and eliminating the large operating losses associated with the divested businesses.

During the fourth quarter ended June 30, 2010, the Company recorded an impairment charge of \$4.5 million, reducing the RFID Technology segment values in anticipation of a sale. The impairment charge was made as of June 30, 2010 with knowledge of the RFID Technology transaction sales value as well as knowledge of the segment’s operating results for the period from July 1, 2010 through the August 17, 2010 sale date of (\$142,200) on sales of \$38,700. The operating loss had been accrued at June 30, 2010 as it represented the minimum cost to maintain the operation for sale and resulted in no income or loss from discontinued operations reported for the six months ending December 31, 2010. The RFID Technology segment operating loss for the six months ended December 31, 2009 was \$754,000, or \$.18 per share on sales of \$563,700.

The results for Discontinued Operations (Data Storage segment and RFID Technology segment) for the six months and three months ended December 31, 2010 and 2009 were as follows:

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## ALANCO TECHNOLOGIES, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

|   | Six Months Ended December 31, |              | Three Months Ended December 31, |         |
|---|-------------------------------|--------------|---------------------------------|---------|
|   | 2010                          | 2009         | 2010                            | 2009    |
| Sales                                       |                               |              |                                 |         |
| Data \$                                     | - \$                          | 829,500\$    | - \$                            | 358,700 |
| Storage                                     |                               |              |                                 |         |
| RFID  | 38,700                        | 563,700      | -                               | 331,800 |
| Technology                                  |                               |              |                                 |         |
| Total \$                                    | 38,700 \$                     | 1,393,200 \$ | - \$                            | 690,500 |
| Sales                                       |                               |              |                                 |         |
| Gross Profit                                |                               |              |                                 |         |
| Data \$                                     | - \$                          | 284,200\$    | - \$                            | 112,000 |
| Storage                                     |                               |              |                                 |         |
| RFID  | 13,500                        | 114,300      | -                               | 123,000 |
| Technology                                  |                               |              |                                 |         |
| Total \$                                    | 13,500 \$                     | 398,500 \$   | - \$                            | 235,000 |
| Gross Profit                                |                               |              |                                 |         |
| Gross Margin                                |                               |              |                                 |         |
| Data  | -                             | 34.3%        | -                               | 31.2%   |
| Storage                                     |                               |              |                                 |         |
| RFID  | 34.9%                         | 20.3%        | -                               | 37.1%   |
| Technology                                  |                               |              |                                 |         |
| Total                                       | 34.9%                         | 28.6%        | -                               | 34.0%   |
| Gross Margin                                |                               |              |                                 |         |
| Selling, General and Administrative Expense |                               |              |                                 |         |
| Data \$                                     | - \$                          | 311,600\$    | - \$                            | 146,000 |
| Storage                                     |                               |              |                                 |         |
| Data  | 100,000                       | 325,000      | 100,000                         | 325,000 |
| Storage asset impairment charge             |                               |              |                                 |         |
| RFID  | 155,700                       | 868,300      | -                               | 367,600 |
| Technology                                  |                               |              |                                 |         |
| \$  | 255,700 \$                    | 1,504,900 \$ | 100,000 \$                      | 838,600 |

Total  
SG&A  
Expense

Income  
(Loss)  
from  
Discontinued  
Operations

|                        |              |                |              |           |
|------------------------|--------------|----------------|--------------|-----------|
| Data \$                | (100,000) \$ | (352,400)\$    | (100,000) \$ | (359,000) |
| Storage<br>RFID        | -            | (754,000)      | -            | (244,600) |
| Technology<br>Total \$ | (100,000) \$ | (1,106,400) \$ | (100,000) \$ | (603,600) |

Operating  
Income  
(Loss)

Capital  
Expenditures

|                        |      |          |      |       |
|------------------------|------|----------|------|-------|
| Data \$                | - \$ | -\$      | - \$ | -     |
| Storage<br>RFID        | -    | 5,600    | -    | 3,900 |
| Technology<br>Total \$ | - \$ | 5,600 \$ | - \$ | 3,900 |

Capital  
Expenditures

Depreciation  
and

Amortization

|                        |          |           |      |        |
|------------------------|----------|-----------|------|--------|
| Data \$                | - \$     | 13,600\$  | - \$ | 6,700  |
| Storage<br>RFID        | 3,400    | 42,300    | -    | 20,200 |
| Technology<br>Total \$ | 3,400 \$ | 55,900 \$ | - \$ | 26,900 |

Depreciation  
and  
Amortization

## ALANCO TECHNOLOGIES, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

Assets and Liabilities related to Discontinued Operations at December 31, 2010 and June 30, 2010 consisted of the following:

|  | December 31, 2010 | June 30, 2010 |
|--|-------------------|---------------|
| Assets related to discontinued operations                |                   |               |
| Accounts receivable, net                                 |                   |               |
| RFID Technology  | \$ 37,000         | -             |
| Total Accounts receivable, net                           | \$ 37,000         | -             |
| Inventory, net   |                   |               |
| Data Storage   | \$ -              | 50,000        |
| RFID Technology  | 2,500             | 860,900       |
| Total Inventory, net                                     | \$ 2,500          | 910,900       |
| Costs and estimated earnings in excess of billings       |                   |               |
| RFID Technology  | \$ -              | 95,200        |
| Total costs and estimated earnings in excess of billings | \$ -              | 95,200        |
| Prepaid expenses and other assets                        |                   |               |
| RFID Technology  | \$ -              | 328,800       |
| Total prepaid expenses and other assets                  | \$ -              | 328,800       |
| Property, plant and equipment, net                       |                   |               |
| RFID Technology  | \$ -              | 59,400        |
| Total costs and estimated earnings in excess of billings | \$ -              | 59,400        |
| Goodwill   |                   |               |
| RFID Technology  | \$ -              | 576,700       |
| Total costs and estimated earnings in excess of billings | \$ -              | 576,700       |
| Total  | \$ 39,500         | 1,971,000     |
| Liabilities related to assets held for sale              |                   |               |
| Billings in excess of costs and estimated earnings       |                   |               |
| RFID Technology  | \$ 23,500         | 98,700        |

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|  |    |             |           |
|--|----|-------------|-----------|
| Total billings in excess of costs and estimated earnings | \$ | 23,500\$    | 98,700    |
| Deferred warranty revenue and customer advances          |    |             |           |
| RFID Technology  | \$ | 751,700\$   | 768,100   |
| Total deferred warranty revenue and customer advances    | \$ | 751,700\$   | 768,100   |
| Accounts payable and accrued expenses                    |    |             |           |
| RFID Technology  | \$ | 657,900\$   | 631,300   |
| Total accounts payable and accrued expenses              | \$ | 657,900\$   | 631,300   |
| Total liabilities related to assets held for sale        | \$ | 1,433,100\$ | 1,498,100 |

Note E – Deferred Revenue

Deferred revenues at December 31, 2010 and June 30, 2010 consist of the following:

## ALANCO TECHNOLOGIES, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

|                              | December 31,<br>2010<br>(unaudited) | June 30,<br>2010 |
|------------------------------|-------------------------------------|------------------|
| Deferred revenue             | \$ 654,800                          | \$ 684,800       |
| Less - current portion       | (325,000)                           | (309,300)        |
| Deferred revenue - long term | \$ 329,800                          | \$ 375,500       |

## Note F - Loss Per Share

Basic and diluted 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, warrants, and convertible debt 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, 2010, there were zero potentially dilutive securities included in the weighted average shares of common stock outstanding as inclusion of outstanding stock options, warrants, and stock issuable upon conversion of debt or preferred stock would be anti-dilutive.

## Note G – Equity

During the six months ended December 31, 2010, the Company issued a total of 840,300 shares of Class A Common Stock. Included were 3,100 shares issued for services valued at \$5,300, 1,100 shares issued for payment of notes and interest valued at \$2,100, 256,200 shares issued for exercise of warrants valued at \$304,800 and 384,300 shares coupled with 95,100 warrants to purchase Class A Common Stock at \$2.64 per share, valued at \$612,400, net of \$55,400 in expenses issued in a private offering to accredited investors, 16,600 common shares issued in payment of certain Series D Preferred Dividend obligations, valued at \$27,100, 34,300 common shares issued in payment of certain Series E Preferred Dividend obligations, valued at \$54,900, 129,700 shares, valued at \$518,900, issued in the conversion of 51,900 Series D Preferred shares to common shares, and 15,000 shares, valued at \$45,000, issued in the conversion of 10,000 Series E Preferred shares to common shares.

The Company declared and paid dividends-in-kind on the Company's Series B Convertible Preferred Stock through the issuance of 5,600 shares of Series B Preferred Stock valued at \$56,000. The Company's Preferred Stocks are more fully discussed in the Form 10-K for the year ended June 30, 2010.

On September 16, 2010, the Board of Directors approved the immediate re-pricing of certain outstanding stock options (approximately 866,000 shares to forty-nine individuals) held by current Officers, Directors and employees to \$1.50 per share, a 7.9% premium to the closing market price on September 15, 2010 of \$1.39. The compensation



value created by the re-pricing, as determined under the Black Scholes method, was approximately \$298,400 and under current accounting rules results in a non cash expense in current and future periods, not to exceed the vesting periods of the stock options. The Company elected to expense in the current quarter the entire increase in stock based compensation resulting from the re-pricing. Accordingly, the value of employee stock-based compensation recognized for the six months ended December 31, 2010 amounted to \$400,700, including the \$298,400 discussed above, compared to \$239,000 recognized in the comparable six months of the prior fiscal year. See Note B – Stock-Based Compensation for additional discussion related to employee stock-based compensation.

During October 2010, the Company raised \$304,800 through the exercise of 256,200 warrants. On October 13, 2010, the Company's Board of Directors approved the re-pricing of certain warrants, held by non officers and directors, to purchase 256,200 shares of the Company's Class A Common Stock. The warrants, with exercise prices

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

ranging from \$4.00 to \$14.40 per share, were re-priced to \$1.19 per share, reflecting an approximate 15% discount from the then current market, and required the warrants to be exercised through October 21, 2010. If the warrants were not exercised by the October 21, 2010 date, the exercise price reverted back to the pre-adjusted price. The warrant re-pricing discount represented the Company's estimate of market value, net of costs, of a private placement of an equal amount and was completed to raise required working capital for the Company.

At June 30, 2010, the Company reported 2,000 treasury shares, valued at \$30,000, representing the estimated number of Alanco shares to be distributed upon the liquidation of a private Company in which Alanco had ownership. During the quarter ended December 31, 2010, the Company received \$18,200 as partial liquidation of its investment. In January 2011, the Company received another \$2,800 as a final distribution and accordingly the Company reduced treasury shares at December 31, 2010 to 200 valued at \$2,800, resulting in a loss of approximately \$9,000, reported in the current quarter as other expense.

Note H – Related Party Transactions

The Company has a line of credit agreement (“Agreement”), more fully discussed in the Company’s Form 10-K for the year ended June 30, 2010 with a private trust (“Lender”) controlled by Mr. Donald Anderson, a greater than five percent stockholder of the Company. Mr. Anderson’s investments in the Company are more fully discussed in Note I (below) – Line of Credit and Term Loan and in the Company’s Form 10-K for the fiscal year ended June 30, 2010.

At December 31, 2010 the principal balance due under the Agreement was \$4.2 million compared to \$5.7 million at June 30, 2010. During the quarter ended September 30, 2010, the Company paid \$1.8 million against the credit line from the sale of the net RFID Technology segment assets. During the quarter ended December 31, 2010, the Company borrowed \$300,000 under the Agreement. See Note I – Line of Credit and Term Loan for additional discussion of the Agreement.

As discussed in the equity footnote above, during the six months ended December 31, 2010, the Company issued a total of 16,600 shares of Class A Common Stock, valued at \$27,100, in payment of Series D Preferred Stock dividends. 5,100 or 30.7% of the Class A Common Stock issued as Series D Preferred Stock dividend payments went to officers and directors of the Company.

On December 16, 2010, the Company issued a \$100,000 note payable to an officer and director for an additional \$100,000 of working capital provided to the Company. The note is unsecured, bears interest at a rate of 12% and is payable within thirty (30) days following written demand for such payment by the Holder.

Note I – Line of Credit and Term Loan

On December 16, 2010, the Company and the Anderson Family Trust agreed to an amendment to the Company’s line of credit which reduced the credit limit on the line to \$4.2M from \$4.7M, extended the maturity date to January 31, 2011 and decreased the conversion price from \$10.00 to \$1.37 on the \$1 million convertible portion of the debt. The amendment also restricted the \$1 million convertible portion to an event of default and placed restrictions on the Company's issuance of stock. The amendment allows for other changes to the credit limit in certain circumstances.

At December 31, 2010, the Company had an outstanding balance under the line of credit agreement of \$4,200,000. The balance is under a \$4.2 million line of credit agreement with a private trust, entered into in June 2002 and last

modified during February of 2011, which extended the maturity date to February 18, 2011 to allow the Company time to evaluate available strategic alternatives. Under the Agreement, the Company must maintain a minimum balance due of at least \$2.5 million through the February 18, 2011 maturity date. Interest is accrued at the prime rate plus 3% (6.25% at December 31, 2010) for any balance up to \$2 million and 12% on balances in excess of \$2 million.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

The Company received a letter of resignation on October 4, 2010, from Don Anderson as a member of the Company's Board of Directors, effective immediately. Mr. Anderson is the owner of approximately 8.6% of the Company's Class A Common Stock, Chairman of the Independent Directors/Nominating Committee, member of the Company's Board of Directors and Trustee of the Anderson Trust, and provider of the Company's Line of Credit arrangement discussed above. A copy of the resignation, with attachments, submitted with the resignation letter was filed as an Exhibit 99.2 to Form 10-K for fiscal year ended June 30, 2010.

In his resignation letter, Mr. Anderson states that the company's auditors have taken a "position" in regards to the additional borrowing capacity available under The Anderson Family Trust Line of Credit. The independent public accountants have taken no such position. In fact, the independent auditors have stated that "at no time were we engaged to render a separate opinion as to the borrowing capacity available under The Anderson Line of Credit and we have had no communications with Mr. Anderson in regards to this matter."

As noted above, the Trust advanced \$300,000 under the agreement during the month of December 2010. In addition, the maturity date was extended through February 18, 2011 to allow the Company to evaluate available strategic alternatives. During the quarter ended December 31, 2010, the Company also made the final \$100,000 payment on a \$4 million term loan financing completed in September of 2006 with ComVest Capital LLC.

Note J – Legal

The Company's subsidiary, StarTrak Systems, has recently been made a defendant concerning certain patent infringement claims as follows:

Arrivalstar S.A, et all. v. StarTrak Systems, LLC, et al. Case No.: 4:10-CV-0033. This action is a patent infringement action venued in the United States District Court for the Northern District of Indiana. StarTrak believes that the plaintiff's patents are invalid due to prior art, based, in part, upon the substantial commercial activity concerning the patent claims long before the patents were applied for or issued.

Innovative Global Systems LLC v. StarTrak Systems, LLC, et al. Case No.: 6:10-CV-00327. This action is another patent infringement action venued in the United States District Court for the Eastern District of Texas. Again, StarTrak believes that the plaintiff's patents are invalid due to prior art, based, in part, upon the substantial commercial activity concerning the patent claims long before the patents were applied for or issued.

Both of these lawsuits are quite early in the discovery stage and StarTrak's counsel has not had the opportunity to form an opinion concerning the likely outcome. However, the Company's management believes that the suits are without merit and the Company will vigorously defend itself in the matters.

The Company may also, from time to time, be involved in litigation arising from the normal course of business. As of December 31, 2010 there was no such litigation pending deemed material by the Company.

ALANCO TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (continued)

Note K – Subsequent Events

The Company and The Anderson Family Trust agreed in January 2011 and again in February 2011 to amend the Line of Credit Agreement extending the maturity date. The last amendment extended the maturity date to February 18, 2011. The Company is working with the lender and expects reasonable future extension requests to be granted. For more information see Note I (above) – Line of Credit and Term Loan and the Company's Form 10-K for the fiscal year ended June 30, 2010.

The Company issued 26,700 shares of its Class A Common Stock in payment of Series D Preferred and Series E Preferred Dividends. The shares were valued at approximately \$38,700 and 2,800 shares valued at approximately \$4,100 or 10.5% were issued to officers and directors of the Company.

On February 11, 2011, the Company received claims and threatened litigation from Tim Slifkin ("Slifkin") and Tom Robinson ("Robinson"), a director and executive officer, respectively, (both employees of StarTrak) alleging that the Company had not recorded a total of approximately \$630,000 of salaries, finders fees and commissions allegedly earned by Slifkin and Robinson and payable at December 31, 2010. In addition, Slifkin and Robinson claimed that upon the completion of future anticipated transactions they will be owed an additional \$335,000 each for a total additional liability of \$770,000.

The unsubstantiated claims received were forwarded to the Company's Board of Directors, Company legal counsel and the Company's independent auditors for review and evaluation. To validate the claims, the Company's auditors requested from Slifkin (Robinson was traveling and could not be reached) that all available documentation, contracts, and calculations supporting the claims be provided to the auditors. Slifkin has not responded to the auditor request and therefore, no documentation or support for the claims has been provided at this time. The Company has not recorded any portion of the unsubstantiated claims at December 31, 2010 and believes, in conjunction with its legal counsel, the claims, as well as any other allegations by Slifkin and Robinson, to be without merit. The Company intends to vigorously defend its position.

Note L – Liquidity

During the six months ended December 31, 2010, the Company reported a net loss of approximately \$2.1 million. During fiscal year ended June 30, 2010, the Company reported a net loss from continuing operations of approximately \$2.6 million. Although the Company raised additional capital during the current quarter and prior year, the significant losses raise doubt about the ability of the Company to continue as a going concern. During fiscal 2011, the Company expects to meet its working capital and other cash requirements with its current cash reserves, cash generated from operations, its borrowing capacity, and other financing as required. While the Company believes that it will succeed in attracting additional capital and generate capital from operations, there can be no assurance that the Company's efforts will be successful. The Company's continued existence is dependent upon its ability to achieve and maintain profitable operations. As a result, the Company's independent registered public accounting firm issued a going concern opinion on the consolidated financial statements of the Company for the fiscal year ended June 30, 2010. The condensed consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

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

Forward-Looking Statements: 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. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words "believe," "may," "estimate," "continue," "anticipate," "intend," "should," "plan," "could," "target," "potentially," "will," "expect" and similar expressions, as they relate to the Company are intended to identify forward-looking statements within the meaning of the "safe harbor" provisions of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. From time to time, the Company may publish or otherwise make available forward-looking statements of this nature. All such forward-looking statements are based on the expectations of management when made and are subject to, and are qualified by, 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, among others, that could affect the outcome of the Company's forward-looking statements: 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; unfavorable result of current pending 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; the ability to maintain satisfactory relationships with suppliers; federal and/or state regulatory and legislative actions; customer preferences and spending patterns; the ability to implement or adjust to new technologies and the ability to secure and maintain key contracts and relationships. New risk factors emerge from time to time and it is not possible to accurately predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any risk factor, or combination of risk factors, may cause results to differ materially from those contained in any forward-looking statements. Except as otherwise required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statements or the risk factors described in this Quarterly Report or in the documents we incorporate by reference, whether as a result of new information, future events, changed circumstances or any other reason after the date of this Quarterly Report on Form 10-Q.

ALANCO TECHNOLOGIES, INC.

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 and pursuant to the rules and regulations of the United States Securities and Exchange Commission. 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 and estimated percent complete on uncompleted contracts in process, stock-based compensation, 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 materially 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 condensed 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, 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 that extend over a reporting period in all business segments 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 is 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.

Fair value of financial instruments – The estimated fair values for financial instruments are determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The carrying amounts of accounts receivable, accounts payable, accrued liabilities, and notes payable approximate fair value given their short-term nature or with regards to long-term notes payable based on borrowing rates currently available to the Company for loans with similar terms and maturities.

Results of Operations

(A) Three months ended December 31, 2010 versus three months ended December 31, 2009

Net Sales

Net sales from continuing operations for the second fiscal quarter ended December 31, 2010 were \$3,958,200, an increase of \$331,000, or 9.1%, compared to net sales of \$3,627,200 reported for the comparable quarter of the prior year. The increase resulted from increased hardware shipments and monitoring revenues compared to the quarter ended December 31, 2009. Although revenues are affected by general economic conditions and may fluctuate on a quarter to



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quarter comparison, management believes that both hardware sales and monitoring revenues will continue to increase throughout fiscal year 2011 through new product introductions and increased market penetration.

#### Gross Profit

Gross profit from continuing operations for the quarter ended December 31, 2010 amounted to \$1,482,900 an increase of \$152,800, or 11.5%, compared to \$1,330,100 in gross profit reported for the comparable quarter of the prior year. The gross profit increase was due to the increase in sales as gross margin increased slightly to 37.5% for the quarter ended December 31, 2010 as compared to 36.7% for the same period of the prior year. Gross margin can be impacted in all business segments by economic conditions and specific market pressures. Management does expect current fiscal year gross margins will continue to improve compared to the same periods in the prior year.

#### Selling, General and Administrative Expenses

Selling, general and administrative (“SG&A”) expenses for the quarter ended December 31, 2010 were \$1,587,500, a \$351,600, or 28.4% increase when compared to the \$1,235,900 reported for the comparable period of the prior year. The increase resulted primarily from increased head count, salaries, and sales expenses.

Corporate expenses reported for the current quarter of \$282,900 represents an increase of \$13,200, or 4.9% increase when compared to \$269,700 reported for the quarter ended December 31, 2009. Corporate expenses for the three months ended December 31, 2010 increased primarily due to slight increases in consulting and operating expenses.

Amortization of stock-based compensation reported for the quarter ended December 31, 2010 decreased to \$59,800, a decrease of \$10,400 or 14.8% when compared to \$70,200 reported in the same quarter of the prior year. The decrease is reflective of outstanding options during the current quarter as compared to the same quarter of the prior year.

Depreciation and amortization expense for the quarter decreased to \$126,300, a decrease of \$8,200, or 6.1% when compared to depreciation and amortization expense of \$134,500 for the same quarter of the prior year. The decrease is due to certain fixed assets reaching full depreciation in prior periods.

#### Operating Loss

Operating Loss for the quarter ended December 31, 2010 was (\$573,600) compared to an Operating Loss of (\$380,200) reported for the same quarter of the prior year, an increase of (\$193,400), or 50.9%. The increased operating loss is the net result of increased operating expenses as noted above.

#### Other Income and Expense

Net interest expense for the quarter decreased to \$86,300, a decrease of \$119,100, or 58%, compared to net interest expense of \$205,400, for the same quarter in the prior year. The decrease is due to reduced borrowing and a reduction in loan amortization costs during the quarter ended December 31, 2010 compared to the prior year quarter. Other expense increased to \$9,000 due to a write down in the value of an investment.

#### Loss From Continuing Operations

Loss from continuing operations for the quarter increased \$82,200, or 14% to (\$668,900) from (\$586,700) in the quarter ended December 31, 2009.

#### Discontinued Operations

The Company reported a loss from Discontinued Operations for the quarter ended December 31, 2010 of (\$100,000), a decrease of \$503,600 compared to a loss from Discontinued Operations of (\$603,600) reported for the comparable quarter of the prior year. The significant decrease in loss from discontinued operations resulted from the sale of the discontinued operations during the quarter ended September 30, 2010. The (\$100,000) loss from discontinued operations for the current quarter represents an additional impairment charge necessary to reflect the estimated

decrease in asset value due to the buyer ceasing operation of the company that acquired the discontinued operation's assets.

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## (Loss) Earnings before Interest, Taxes, Dividends, Depreciation &amp; Amortization (EBITDA)

The Company believes that earnings (loss) before net interest expense, income taxes, depreciation and amortization (EBITDA) is an important measure used by management to measure performance. EBITDA may also be used by certain investors to compare and analyze our operating results between accounting periods. However, EBITDA should not be considered in isolation or as a substitute for net income, cash flows or other financial statement data prepared in accordance with US GAAP or as a measure of our performance or liquidity. EBITDA from Continuing Operations for Alanco's 2011 fiscal year second quarter was a loss of (\$456,300) an increase of (\$209,500) when compared to an EBITDA loss of (\$246,800) for the same quarter of the prior fiscal year. EBITDA before Stock-based compensation and Corporate Expense for the current quarter was a loss of (\$113,600), a decrease of \$206,700, when compared to an income of \$93,100 for the comparable quarter of the prior year. A reconciliation of the EBITDA calculations is presented below:

## EBITDA RECONCILIATION to NET LOSS FROM CONTINUING OPERATIONS

(Unaudited)

|   | 3 months ended<br>December 31,<br>2010 | 3 months ended<br>December 31,<br>2009 |
|---|--|--|
| EBITDA before<br>Stock-based<br>compensation<br>and<br>Corporate<br>Expense | \$ (113,600)                           | \$ 93,100                              |
| Corporate<br>Expense  | (282,900)                              | (269,700)                              |
| Stock-based<br>compensation   | (59,800)                               | (70,200)                               |
| EBITDA  | (456,300)                              | (246,800)                              |
| Net<br>interest<br>expense  | (86,300)                               | (205,400)                              |
| Depreciation<br>and<br>amortization   | (126,300)                              | (134,500)                              |
| NET LOSS FROM<br>CONTINUING<br>OPERATIONS                                   | \$ (668,900)                           | \$ (586,700)                           |

Dividends

Preferred stock dividend expense for the three months ended December 31, 2010 was \$79,800, a decrease of \$37,900, or 32.2%, compared to the \$117,700 in preferred stock dividends recorded in the comparable period of the prior fiscal year. The decrease resulted primarily from a reduction of Series D Preferred Stock outstanding and the dividend rate reduction negotiated in March 2010.

Net Loss Attributable to Common Shareholders

Net Loss Attributable to Common Shareholders for the quarter ended December 31, 2010 amounted to (\$848,700), or (\$.16) per share, a \$459,300 improvement when compared to a loss of (\$1,308,000), or (\$.31) per share in the comparable quarter of the prior year. The Company anticipates improved future operating results, however, actual results may be affected by unfavorable economic conditions and reduced capital spending budgets. If the economic conditions in the United States deteriorate or if a wider global economic slowdown occurs, Alanco may experience a material adverse impact on its operating results and business conditions.

(B) Six months ended December 31, 2010 versus six months ended December 31, 2009

Net Sales

Net sales from continuing operations for the six months ended December 31, 2010 were \$7,652,800, an increase of \$1,048,700, or 15.9%, compared to net sales of \$6,604,100 reported for the comparable period of the prior year. The increase resulted from increased hardware shipments and monitoring revenues under major contracts during

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the six months ended December 31, 2010 as compared to the comparable period of the prior year. Although revenues are affected by general economic conditions and may fluctuate on a quarter to quarter comparison, management believes that both hardware sales and monitoring revenues will increase throughout fiscal year 2011 through new product introductions and increased market penetration.

#### Gross Profit

Gross profit from continuing operations for the six months ended December 31, 2010 amounted to \$2,686,300, an increase of \$83,700, or 3.2% compared to \$2,602,600 in gross profit reported for the six month period ended December 31, 2009. The gross profit increase is reflective of the increase in sales in the current quarter as compared to the same quarter of the prior year. The gross margin for the six months ended December 31, 2010 was 35.1% as compared to 39.4% for the same six month period of the prior year. The decrease in gross margin was due primarily to a one-time credit of approximately \$200,000 recorded to the data services cost of sales in the prior year quarter ended September 30, 2009, related to a vendor adjustment. Gross margin can be impacted by economic conditions and specific market pressures. As a result, the changes in gross margins reported for the current period are not considered to be trends. Management does expect current fiscal year gross margins will improve compared to the same periods in the prior year.

#### Selling, General and Administrative Expenses

Selling, general and administrative (“SG&A”) expenses for the six months ended December 31, 2010 were \$3,135,000, a \$704,500, or 29% increase when compared to the \$2,430,500 reported for the comparable period of the prior year. The increase is primarily due to increased head count, salaries, and higher sales and marketing expense.

Corporate expenses reported for the six months ended December 31, 2010 were \$585,800, an increase of \$155,300, or 36.1%, compared to \$430,500 reported for the six months ended December 31, 2009. The prior year six months ended December 31, 2009 included activity during the quarter ended September 30, 2009 whereby the Arizona Court of Appeals vacated an award of attorney’s fees and damages awarded to the Plaintiff in the Arriad Property lawsuit resulting in the reversal of related accruals in the amount of \$126,800. The current six months ended December 31, 2010 includes an additional release of \$25,000 of accruals for the Arriad Property lawsuit. If both quarters were adjusted for the unusual credits, the corporate expenses for the six months ended December 31, 2010 would reflect an increase of \$53,500, or 9.6%, which is primarily due to increased consulting and operating expenses.

Amortization of stock-based compensation reported for the six months ended December 31, 2010 increased to \$397,700, an increase of \$158,700, or 66.4% when compared to \$239,000 for the same six months of the prior year. The net increase is the result of the Company’s election to re-price certain employee stock options during the quarter ended September 30, 2010, as described above in Note G – Equity, and to expense in the first quarter of the fiscal year the entire \$298,400 increase in Black-Scholes value of the re-priced options in the quarter ended September 30, 2010 offset by a reduction in the base stock option expense resulting from less grants in the current period.

Depreciation and amortization expense for the six months ended December 31, 2010 decreased slightly to \$256,500, a decrease of \$13,600, or 5% when compared to \$270,100 in the prior year. The decrease is due to certain fixed assets reaching full depreciation in prior periods.

#### Operating Loss

Operating Loss for the six months ended December 31, 2010 was (\$1,688,700) compared to an Operating Loss of (\$767,500) reported for the same period of the prior year, an increase of (\$921,200). The increased operating loss is primarily due to increased operating expenses and amortization expense related to the stock option re-pricing during the six months ended December 31, 2010 as compared to the same period of the prior year.

#### Other Income and Expense

Net interest expense for the six months ended December 31, 2010 decreased to \$254,100, a decrease of \$125,800, or 33.1%, compared to net interest expense of \$379,900 for the same period in the prior year. The decrease is due to reduced borrowing and a reduction in loan amortization costs during the six months ended December 31, 2010 compared to the prior year.

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The Company reported an increase in Other Expense from (\$1,900) in the first six months of the prior fiscal year to (\$9,300) reported in the current six month period ended December 31, 2010. Other expense increased in the current six month period compared to the comparable period of the prior year due to a write down in the value of an investment.

## Loss From Continuing Operations

Loss from continuing operations for the six months increased (\$802,800), or 69.9% to (\$1,952,100) from (\$1,149,300) in the six months ended December 31, 2009. The increased loss is the net result of slightly improved gross profit offset by increased operating expenses.

## Discontinued Operations

The Company reported a loss from Discontinued Operations for the six months ended December 31, 2010 of (\$100,000), a significant decrease compared to the reported loss from discontinued operations of (\$1,106,400) reported for the comparable period of the prior year. The significant decrease when compared to the prior year reflects the limited activities of the discontinued operations during the current fiscal year due to the sale of the RFID Technology segment assets in the quarter ended September 30, 2010. The Company recorded an additional impairment charge in the current period of approximately \$100,000 on the sale of the data storage segment.

## (Loss) Earnings before Interest, Taxes, Dividends, Depreciation &amp; Amortization (EBITDA)

The Company believes that earnings (loss) before net interest expense, income taxes, depreciation and amortization (EBITDA) is an important measure used by management to measure performance. EBITDA may also be used by certain investors to compare and analyze our operating results between accounting periods. However, EBITDA should not be considered in isolation or as a substitute for net income, cash flows or other financial statement data prepared in accordance with US GAAP or as a measure of our performance or liquidity. EBITDA from Continuing Operations for Alanco's six months ended December 31, 2010 was a loss of (\$1,441,500), an increase of \$942,200 when compared to an EBITDA loss of (\$499,300) for the same period of the prior fiscal year. EBITDA before Stock-based compensation and Corporate Expense for the current six month period was a loss of (\$458,000), a reduction of (\$628,200) when compared to income of \$170,200 for the comparable period of the prior year. A reconciliation of the EBITDA calculations is presented below:

## EBITDA RECONCILIATION to NET LOSS FROM CONTINUING OPERATIONS

(Unaudited)

|   | 6 months ended<br>December 31,<br>2010 | 6 months ended<br>December 31,<br>2009 |
|---|--|--|
| EBITDA before<br>Stock-based<br>compensation<br>and<br>Corporate<br>Expense | \$ (458,000)                           | \$ 170,200                             |
| Corporate<br>Expense  | (585,800)                              | (430,500)                              |
|   | (397,700)                              | (239,000)                              |

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Stock-based  
compensation

|   |                |                |
|---|----------------|----------------|
| EBITDA                                    | (1,441,500)    | (499,300)      |
| Net<br>interest<br>expense                | (254,100)      | (379,900)      |
| Depreciation<br>and<br>amortization       | (256,500)      | (270,100)      |
| NET LOSS FROM<br>CONTINUING<br>OPERATIONS | \$ (1,952,100) | \$ (1,149,300) |

Dividends

Dividend expense for the six months ended December 31, 2010 was \$159,600, a decrease of \$98,600, or



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38.2% when compared to the \$258,200 in preferred stock dividends recorded in the comparable period of the prior fiscal year. The decrease resulted from a decrease in Series D Preferred Stock outstanding and a negotiated reduction in the Series D dividend rate in March 2010.

#### Net Loss Attributable to Common Shareholders

Net Loss Attributable to Common Shareholders for the six months ended December 31, 2010 amounted to (\$2,211,700), or (\$.42) per share, an improvement of \$302,200 when compared to a loss of (\$2,513,900), or (\$.60) per share, in the comparable six months of the prior year. Future operating results may be affected by unfavorable economic conditions and reduced capital spending budgets. If the economic conditions in the United States deteriorate or if a wider 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 liabilities at December 31, 2010 exceeded current assets by \$3,914,900, resulting in a current ratio of .56 to 1. At June 30, 2010, current liabilities exceeded current assets by \$3,388,900 reflecting a current ratio of .67 to 1. The change in current ratio at December 31, 2010 versus June 30, 2010 resulted primarily from the repayment of \$2 million in current Notes payable as a result of the sales of the RFID Technology segment assets. The Company's significant line of credit balance is classified as a current liability at both December 31, 2010 and June 30, 2010. See Note I – Line of Credit and Term Loan for further details on notes payable.

Consolidated accounts receivable of \$1,984,200 at December 31, 2010 (including both continuing and discontinued operations) reflects a decrease of \$509,700, or 20.4%, when compared to the \$2,493,900 reported as consolidated accounts receivable at June 30, 2010. The accounts receivable balance at June 30, 2010 includes \$204,900 of receivables from business segments reported as "Assets Held for Sale" since the Company had anticipated retaining the accounts receivable balances in a sales transaction. By December 31, 2010, the operations had been sold and any accounts receivable related primarily to the sales transaction were appropriately reports as "Assets Related to Discontinued Operations." If we exclude the \$204,900 of accounts receivable related to operations held for sale at June 30, 2010, the remaining balance of \$2,289,000 represents the Wireless Asset Management segment, the Company's only continuing operation.

The Wireless Asset Management segment accounts receivable balance at December 31, 2010 was \$1,984,200, a decrease of \$304,800, or 13.3%, when compared to the comparable balance at June 30, 2010 of \$2,289,000. The \$1,984,200 balance at December 31, 2010 represents forty-seven days sales in receivables compared to an accounts receivable balance at June 30, 2010 of \$2,289,000 representing fifty-seven days sales in receivables.

Inventories at December 31, 2010 and June 30, 2010 represent only inventories for the Wireless Asset Management segment and amounted to \$1,848,900, an increase of \$626,400, or 51.2%, when compared to \$1,222,500 at June 30, 2010. The inventory balance at December 31, 2010 for the Wireless Asset Management segment represents an inventory turnover of 5.4 compared to 7.1 as of June 30, 2010. The Company does not consider the reduced inventory turnover a trend and anticipates that the calculation will fluctuate from quarter to quarter.

At December 31, 2010, the Company had fully drawn \$4.2 million under its line of credit agreement. See Note I - Line of Credit and Term Loan for additional discussion of the existing line of credit agreement.

Cash used in operations for the six-month period ended December 31, 2010 was \$851,500, a decrease of 308,400, or 26.6%, when compared to cash used in operations of \$1,159,900 for the comparable period ended December 31, 2009. The decrease in cash used in operating activities during the six-month period resulted primarily from a decrease in net loss and the net decrease in accounts receivable, customer advances, accounts payable and accrued expenses as

offset by increases in inventories and deferred revenue.

During the six-months ended December 31, 2010, the Company reported cash provided by investing activities

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of \$1,995,100 compared to cash used by investing activities of \$10,900. The change reflects the Company's receipt of proceeds from the sale of net RFID Technology segment assets during the quarter ended September 30, 2010.

Cash used by financing activities for the six-months ended December 31, 2010 amounted to \$1,006,500 compared to cash provided by financing activities of \$1,127,800 for the six-months ended December 31, 2009. The change is primarily reflective of the Company's repayment on borrowings during the quarter ended September 30, 2010 from the proceeds of the sale of the Company's net RFID Technology segment assets.

The Company believes that additional cash resources may be required for working capital to achieve planned operating results for fiscal year 2011 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 December 31, 2010. 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 2011. While the Company believes that it will succeed in attracting additional capital and generate capital from operations from its StarTrak acquisition, there can be no assurance that the Company's efforts will be successful. The Company's continued existence is dependent upon its ability to achieve and maintain profitable operations. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

Item 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable to smaller reporting company.

Item 4 - CONTROLS AND PROCEDURES

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company carried out, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended).

Based on their evaluation, the Company's Chief Executive Officer and its Chief Financial Officer concluded that, the Company's disclosure controls and procedures were not effective as of the end of the period covered by this report, because of the material weaknesses previously identified as of June 30, 2010 and the lack of appropriate independent verification supporting the proper disposal of some \$415,000 of obsolete inventory, previously reserved, during the quarter ended December 31, 2010. The inventory was disposed of by a subcontractor at the direction of StarTrak management who had reviewed inventory values in previous periods. Notwithstanding the existence of the material weaknesses identified as of June 30, 2010 and the additional material weaknesses identified during the quarter ended December 31, 2010, management has concluded that the condensed consolidated financial statements in this Form 10-Q fairly present, in all material respects, the Company's financial position, results of operations and cash flows for the periods and dates presented.

(b) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The Company is continuing the process of developing and implementing a remediation plan to address the material weaknesses as described in Item 9(A)T of our June 30, 2010 Form 10-K.

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The Company has taken or will be taking the following actions to improve internal control over financial reporting:

- During the remaining period through the year ending June 30, 2011, we intend to devote resources to properly assess, and remedy if needed, our control environment and entity-level controls.
- During the remaining period through the year ending June 30, 2011, we will enhance our risk assessment, internal control design and documentation and develop a plan for testing in accordance with applicable standards.
- The Company has instituted additional requirements relative to the disposal of obsolete inventory, requiring written management approvals and third party verification of the disposal. In addition, the Company has developed a separate obsolete inventory policy, discussing inventory turnover requirements and net realizable value calculations that will be implemented during the quarter ending March 31, 2011.
- The Company plans to continue to enhance the staffing and competency level within the department with training and periodic reviews.
- The Company has implemented additional review procedures relative to payments to ST Wireless, an India based company that provides software engineering services to StarTrak Systems LLC, to enhance internal controls relative to issues discussed in the Company's Form 10-K filed on October 7, 2010.

In light of the aforementioned material weakness, management conducted a thorough review of all significant or non-routine adjustments for the six month period ended December 31, 2010. As a result of this review, management believes that there are no material inaccuracies or omissions of material fact and, to the best of its knowledge, believes that the condensed consolidated financial statements for the six month period ended December 31, 2010 fairly present in all material respects the financial condition and results of operations for the Company in conformity with U.S. generally accepted accounting principles.

## PART II. OTHER INFORMATION

### Item 1. LEGAL PROCEEDINGS

The Company's subsidiary, StarTrak Systems, has recently been made a defendant concerning certain patent infringement claims as follows:

Arrivalstar S.A, et al. v. StarTrak Systems, LLC, et al. Case No.: 4:10-CV-0033. This action is a patent infringement action venued in the United States District Court for the Northern District of Indiana. StarTrak believes that the plaintiff's patents are invalid due to prior art, based, in part, upon the substantial commercial activity concerning the patent claims long before the patents were applied for or issued.

Innovative Global Systems LLC v. StarTrak Systems, LLC, et al. Case No.: 6:10-CV-00327. This action is another patent infringement action venued in the United States District Court for the Eastern District of Texas. Again, StarTrak believes that the plaintiff's patents are invalid due to prior art, based, in part, upon the substantial commercial activity concerning the patent claims long before the patents were applied for or issued.

Both of these lawsuits are quite early in the discovery stage and StarTrak's counsel has not had the opportunity to form an opinion concerning the likely outcome. However, the Company's management believes that the suits are without merit and the Company will vigorously defend itself in the matters.

The Company may also, from time to time, be involved in litigation arising from the normal course of business. As of December 31, 2010 there was no such litigation pending deemed material by the Company.

ALANCO TECHNOLOGIES, INC.

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

During the six months ended December 31, 2010, the Company issued 5,600 Shares of Series B Preferred Stock as in-kind dividend payments and a total of 840,300 shares of Class A Common Stock, including 3,100 shares for services rendered, 1,100 shares issued for payment of notes and interest, 256,200 shares issued for the exercise of warrants, 384,300 shares issued in a private offering to accredited investors, 16,600 as Series D Preferred Stock dividends, 34,300 as Series E Preferred Stock dividends, 129,700 shares in the conversion of 51,900 shares of Series D Preferred Stock into Class A Common Stock, and 15,000 shares in the conversion of 10,000 shares of Series E Preferred Stock into Class A Common Stock.

Item 4. REMOVED AND RESERVED

ALANCO TECHNOLOGIES, INC.

Item 6. EXHIBITS

- 31.1 Certification of Chief Executive Officer
- 31.2 Certification of Chief Financial Officer
- 32.1 Certification of Chief Executive Officer
- 32.2 Certification of 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  
Chief Financial Officer  
Alanco Technologies, Inc.



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-Q 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 small business issuer as of, and for, the period presented in this report;
4. The small business issuer'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 small business issuer 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 small business issuer, 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 small business issuer'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 small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer'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 small business issuer'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 small business issuer's internal control over financial reporting.

Date: February 18, 2011

/s/ Robert R. Kauffman

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Robert R. Kauffman  
Chairman and Chief Executive Officer

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ALANCO TECHNOLOGIES, INC.

EXHIBIT 31.2

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

I, John A. Carlson, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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 small business issuer as of, and for, the period presented in this report;
4. The small business issuer'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 small business issuer, 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 small business issuer'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 small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and
5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer'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 small business issuer'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 small business issuer's internal control over financial reporting.

Date: February 18, 2011

/s/ John A. Carlson

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John A. Carlson  
Executive Vice President and Chief Financial  
Officer

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ALANCO TECHNOLOGIES, INC.

EXHIBIT 32.1

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of Alanco Technologies, Inc. (the "Company") on Form 10-Q for the period ending December 31, 2010, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert R. Kauffman, Chairman and Chief Executive Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company for the periods presented.

/s/ Robert R. Kauffman  
Robert R. Kauffman  
Chairman and Chief Executive Officer  
Alanco Technologies, Inc.

Dated: February 18, 2011

ALANCO TECHNOLOGIES, INC.

EXHIBIT 32.2

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of Alanco Technologies, Inc. (the "Company") on Form 10-Q for the period ending December 31, 2010, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John A. Carlson, Executive Vice President and Chief Financial Officer of the Company, certify to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company for the periods presented.

/s/ John A. Carlson  
John A. Carlson  
Chief Financial Officer  
Alanco Technologies, Inc.

Dated: February 18, 2011